Privatization and Post-Privatization as a Type of Industrial Policies[1]
(A Report of the Institute for Market Economics)

Introduction

In order to examine the role of the core executive in the privatization process in Bulgaria, this report is divided into three parts. The first contains background information and relevant data concerning the country's privatization programs and highlights some features, which, according to our sources, most characterize it[2]. Based on an overview of the political background within which the institutional structures and procedures for privatization have been designed and developed, the second part illustrates the constellation of core executive actors and institutions involved in privatization, their policy styles, the resources that they have at their disposal and the constraints under which they operate. The concluding section highlights some overall patterns of Bulgaria's privatization process and summarizes our findings with regard to the role that the core executive plays within it. The third part deals with post-privatization matters.

I. The main features of Bulgaria's privatization programme

Since 1989, privatization in Bulgaria has taken three main forms:
1) Restitution of land and urban property;
2) Cash sale of state and municipal assets;
3) So-called 'mass privatization', or voucher privatization.

The restitution of land and urban property is regulated by the 1991 'Restitution Law' and 'Land Act', as well as by implementing provisions which allow for some 5% of all equities to be set aside for restitution claims. The 1992 'Privatization Law' regulates the other methods, and by-laws contain provisions on the different procedures for cash sales[3].

At different moments in time, these methods have been used simultaneously and in various combinations. At present, all of them are being applied to assets still in public ownership/control. This feature required that reference be made to them all. However, in what follows, the focus will only be on cash sales and voucher privatization[4].

[1] The report is an updated version of 1999 report on privatization issues.
[2] This part of the report uses a 1999 report by Luisa Perrotti of INSEAD and Krassen Stanchev of IME to OECD/SIGMA and the World Bank and draws from some 20 interviews then conducted with members of the Bulgarian cabinet, central and local government and agencies' officials, privatization intermediaries and representatives of the business community, as well as our own research.
[3] Examples of such by-laws are the 'Ordinance on Auctions', the 'Ordinance on Tenders', the 'Rules for conducting negotiations with potential buyers', etc…
[4] Concerning the restitution of goods expropriated under the communist rule, be it sufficient to mention here that, of the two objects of this aspect of the privatization process - land and urban property - the former has been the most complicated and controversial. This was due both to the symbolic value attached to land restitution, which triggered considerable political controversy over its implementation, and to legal issues arising from the definition of the ownership regime of restituted land. In spite of the relatively early adoption of the Land Act (1991), for instance, by the third quarter of 1996 less than 1/5 of arable land had actually been returned to their owners with defined boundaries. This was

1. The 'scale' of the enterprise

Besides sparse and unregulated privatizations undertaken in the immediate aftermath of the fall of the communist regime, the first regulated privatization programme of Bulgaria dates back to 1993[5]. This followed the Parliament's approval in April 1992 of the above-mentioned *ad hoc* legislation ('Transformation and Privatization of State-owned and Municipal-Owned Enterprise Act', hereafter 'Privatization law').

Between 1993 and 1998, 1371 state-owned companies, and detached units of other 1384 enterprises have been privatized. Measured as a percentage of the overall estimated value of the enterprises, the deals contracted thus-far amount to just above 30% of the total state-owned assets. The government's target for 1999 is to raise this percentage to 50%[6], while rough estimates indicate that some 16,000 enterprises remain to be privatized.

In the same period, receipts from privatization amounted to some US $ 4,015 million, including $ 1,647 million proceeds, $ 503 million liabilities paid or undertaken by investors, and $ 1,865 million investments to which buyers have committed as part of the privatization contracts.

The (%) share of state-owned assets privatized by years

	1993	1994	1995	1996	1997	1998	1999	Total
Assets subject to privatization	0.56	2.47	1.62	6.19	27.81	6.80	25.79	71.24
Total state-owned assets	0.37	1.63	1.07	4.09	18.36	4.49	17.03	47.04

Source: Privatization Agency

Fiscal Effects

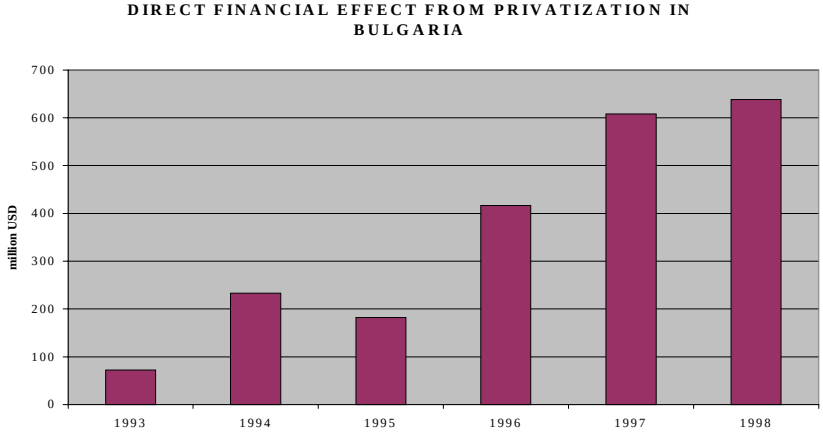
	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**Total**
Direct Financial Effect (m USD)	**72.185**	**232.810**	**181.919**	**416.573**	**607.997**	**637.953**	**2 149.437**
Payments Contracted	44.233	144.252	113.702	184.764	571.828	587.870	1 646.649
Corporate Liabilities Undertaken	12.702	32.956	57.553	218.297	35.040	50.083	406.631
Corporate Liabilities Paid	15.249	55.602	10.665	13.512	1.129	0	96.157
Investments Contracted	**58,971**	**201,738**	**151,914**	**170,561**	**891,346**	**390,912**	**1,865.442**

notwithstanding 54% of the claims had been processed and decided upon. On the other hand, the restitution of urban property has proceeded at a faster pace. Already between 1992 and 1995, over 22,000 small and medium enterprises had been privatized under the Restitution Law, thereby resolving the largest part of submitted claims by previous owners and their heirs.

[5] Examples of privatization which took place before in the lack of regulatory instruments are some transfers of property of wine and textile export firms, as well as of some other foreign trade sector monopolies, to the respective management, which took place in 1990-1991.

[6] Privatization Agency, *Privatization Strategy and Programme*, no date (1999), pp. 2 and 4.

The ever-growing absolute number of deals in the years under consideration, and how they reflect the increasing government's commitment towards privatization will be further discussed below. In the present context is relevant to point out that, in spite of the latter features, as indicated by the graph below the process of privatization has been uneven in terms of revenues. The low figures for 1995, in particular, require a twofold explanation: on the one hand, they correspond to a change in the administration, following the general elections of December 1994. On the other hand, whilst few cash privatization deals were concluded in that year, 1995 marked the preparation of the first program of mass privatization, which constitutes an important turning point in the policy, to which we shall turn later in this section.



As for the component of such revenues, foreign investment contributed a large share of privatization receipts. For instance, the 58 deals contracted by the central government's Privatization Agency between 1993-1998 with foreign investors contributed some $ 620 million revenues. This amount constitutes a significant part of foreign investments in Bulgaria in this period, and 38 % of the total privatization proceeds.

Contractual Payments vs. Cash Proceeds in Bulgarian Privatization (million USD)

Year	1993	1994	1995	1996	1997	1998	1999	2000
Payments contracted	44	144	114	185	572	585	646	2.168
Cash proceeds	11	21	59	85	325	201	283	847

Source: Privatization Agency, Ministry of Finance

10 largest deals with foreign buyers (excluding banks)[7]

Name of the company	**Sector**	**Shares sold (%)**	**Revenue (m USD)**	**Buyer**	**Year**
Sodi – Devnya	Chemical	60	160	Solvay	1997
MDK – Pirdop	Copper	56	80	Union Miniere Group	1997
Devnya Cement	Cement	70	44.6	Marvex	1997
Balkan – Sofia	Tourism	67	22.3	DAEWOO	1996

[7] These deals with foreign investors are ranked by the payments contracted, regardless of investment commitments and undertakings to redeem liabilities.

SOMAT – Sofia	Transport	93	21.9	Willi Betz GmbH	1998
Zagorka – Stara Zagora	Brewery	80	21.7	Brewinvest S. A.	1994
Tzarevichni Producti – Razgrad	Food	81	20	Amylum	1993
Intrerpred WTC - Sofia	Trade	70	20	DAEWOO Group	1997
Druzhba – Plovdiv	Glass	51	20	Black Overseas Ltd.	1998
Albena Resort - Balchik	Tourism	33	10.1	BNP, London	1997

However, according to some interviewees, the overall patterns of the privatization process in Bulgaria do not seem the most conducive to foreign investment. Thus, at least in the next stages of the process, it is difficult to anticipate large flows of foreign capital besides, perhaps, the expected interest of foreign investors in the privatization of public utilities.

As for the allocation of privatization receipts (see table below), it may be interesting to note that in 1995 and 1996 all revenues were re-distributed to funds external to the central budget. In 1997, this approach was dramatically reverted, with over 80% of the revenues accruing to the central budget. In 1998, the approach changed once more, with almost half of the receipts being re-allocated to off-central budget funds. Thus, the sparse data available, and the extensive 'finalization' of privatization receipts, make it difficult to estimate the actual impact of privatization on the reduction of the country's deficit.

Allocation from revenues from privatization (1995-1998)

1. Revenues from privatization	1995	1996	1997	1998
a) central budget	-	-	84,2	54
b) off-central budget accounts	100	100	15,8	46

2. (Selected) Funds	1995	1996	1997	1998
Fund for the expenses arising from privatization	4,5	2,1	0,6	5,6
Support of the Agricultural Development Fund	9,2	-	-	-
Mutual Fund	12,2	19,5	0,4	-
National Environmental Protection Fund	3,2	1,5	0,4	2,8
Agriculture State Fund	0,6	7,9	2,1	14,7
Tobacco Fund	0,1	1,2	0,3	2,3
State Fund for Reconstruction and Development	46,1	17,5	4,6	18,1
Artists' Fund of the Ministry of Culture	-	-	-	1,1
Social Security Fund	-	5,9	2,5	10,7
Universities, ministries and hospitals	-	-	1,7	1,2

Source: Ministry of Finance, 1999

Point '1' indicates the two primary recipients of the revenues: that is, the central budget and different off-budget accounts and funds. Point '2' contains a selected list of off-budget accounts and funds that have been injected with privatization proceeds. For instance, between 1995 and 1998, an average 3.2% per cent of the revenues accruing to the central budget have been re-distributed to a Fund established under art. 6 of the Privatization law to cover

expenses deriving from privatization[8].
Finally, it is important to point out that, until the end of 1996, virtually all the largest state-owned enterprises were considered 'strategic' and non-privatisable. At present, the long-postponed privatization of such firms is a high priority on the government's agenda. However, it is difficult to calculate the expected overall outcome of these privatizations. This is because some of the largest enterprises in this group (in terms of capital and manpower) are on the brink of bankruptcy and likely to be privatized at 'nominal prices', whilst others are more profitable and expected to accrue considerable revenues to the Treasury[9].

2. Bulgarian-style voucher privatization

In Bulgaria, the Czech-like voucher privatization takes the name of 'mass privatization'. This method has been applied twice: the first time in 1995-1996, under a socialist government, and the second time, although in an entirely revised form, under the current government, that took office in April 1997. Although the relative impact of voucher privatization on the divesting of State-owned assets is fairly limited, it is relevant within the scope of this report to highlight its main features[10].

a) The first wave

The preparation of the first scheme started in 1995, but it was completed only between the end of 1996 and the beginning of 1997. As a result of the process, some 85 million shares were offered to the public, of which over 80 % were sold. As it will be further illustrated below, the time frame of the process is significant since the implementation of the scheme took place when the socialist government in power, already facing a crisis, was also under considerable pressure from international financial institutions.

According to the program, stake sizes varying between 10 and 90% of 1,050 state-owned enterprises, some of which comparatively well performing, were included in a list of companies to be privatized through a voucher system. 10% of every stake offered was to be divested free of charge to the respective company's workers and managers, whilst the remaining 90% was to be offered to the public through centralized auctions. Every Bulgarian citizen resident in the country and above the age of 18 was entitled to receive a voucher book containing 25,000 investment vouchers. In spite of their nominal value of 25,000 Bulgarian Leva (hereafter BGN), voucher books - which were inheritable and could be transferred to relatives - were sold at the price of 500 BGN (c.ca $ 7.5)[11].

[8] Among these funds, as the table illustrates, the largest share of privatization revenues has accrued to the State Fund for Reconstruction and Development (SFRD). This fund was created in 1991 to support structural reform and the re-payment of foreign debts. Beside privatization revenues, other sources of funding for the SFRD were loans, subsidies and transfers. In fact, after the necessary resources had been allocated to repay such debt, SFRD also extended short- and medium-term loans through selected commercial banks. Following an agreement with the IMF, the fund was closed in 1998.

[9] In this respect the example of the loss-making and hugely indebted largest steel firm (Kremikovtzi) can be contrasted to that of the Tobacco monopoly.

[10] Concerning the relative weight of the first wave of mass privatization against the total value of the State's long-term assets, available sources provide somewhat contrasting figures: some indicate a relative impact of 7-9%, while others report a slightly higher percentage of 11-13%.

[11] At that stage, the Privatization Law defined the 'voucher' as a book entry, non-interest-bearing

About half of the 6.3 million potential participants took part in the programme. Some 2.5 million, bearing over 80% of the vouchers, transferred them to one or more 'Privatization funds', mostly established by domestic banks or by the managers of large State-owned enterprises. According to *ad hoc* legislation ('Privatization Fund Act'), the Funds were constituted as a distinctive type of investment companies, entitled to collect the vouchers to build their own capital. In their turn, the Funds could invest such capital in up to 34% of the shares of companies included in the Government Program for Mass Privatization.

In connection with the program, the Bulgarian Securities and Exchange Commission licensed 81 such Funds. At a later stage, these were required to transform their legal status into that of public companies and to register their shares in the Central Securities Depository, upon which the transferability of the Fund's shares was no longer constrained. As a result of the process, the Funds became the main private shareholders in over 700 companies and, as of April 1998, approximately 350 such companies were traded on the free segment of the Bulgarian Stock Exchange.

Although the post-privatization performance of the Funds has been very uneven, it is argued that the scheme contributed to the establishment of the Bulgarian capital market. Yet, although the mass privatization process arguably initiated the public to the very notion of control over immaterial property, management services and financial intermediaries in the capital market, local analysts also point out that, in economic and financial terms, the overall value of the enterprise is marginal[12].

b) The second wave

The second wave of mass privatization has just started, in February 1999. To reflect a policy shift announced by the government, the decision to resort to this method of privatization is rationalized more in terms of the need to accelerate privatization than, as in the previous case, in order to pursue objectives of 'social fairness'. In fact, unlike in 1996, there is currently no fixed list of State-owned enterprises to be privatized through this method. Instead, the policy provides that minority stakes (up to 5%) of all State-owned enterprises be offered to the public at large through centralized bidding sessions.

It is not clear how such a limited percentage of shares can actually accelerate the privatization process. Moreover, according to some interviewees, only 'unattractive' companies are likely to be included in the scheme. Yet, it is surely too early to evaluate the effects of the second wave of mass privatization. In fact, our purpose in referring to this scheme is merely to stress that the government's recourse to multiple methods of privatization, including that based on vouchers,

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security. The price of the voucher book was reduced to 100 BGN for pensioners and students, and minors under the age of 18 with at least one deceased parent received a voucher book free of charge.

[12] In particular, it is pointed out that the capital of companies included in first wave of mass privatization was determined mostly in the years 1992 to 1994. Although, due to a series of concomitant circumstances, the purchasing power of the vouchers rose, at the time of the auctions (1996) such capital was highly undervalued, due to high inflation and currency depreciation. Such undervaluing persisted throughout 1998, with privatization funds keeping the capital booked at the artificially low level of 1 Voucher per 1 BGN.

was not an isolated phenomenon.

As mentioned above, the second wave of mass privatization was conceived in a radically amended form. Not only, whilst there are several different alternatives to invest the vouchers (for instance, in pension funds), privatization funds have been excluded from the process. Furthermore, the price at which the shares are acquired is not fixed but weighted against the average of all bids, multiple range of payment instrument (including cash) is allowed, vouchers are not tradable, and entirely new negotiable instruments - 'compensatory bonds' - can be issued against claims on formerly nationalized properties, to complement the 'restitution' side of the privatization programme.

3. Management-employee buy-outs

The privatization law introduced a special regime for management-employee buy-outs (MEBO) of cash privatization deals. In particular, a preferential payment system allows management-employee buyer companies to provide a down payment amounting to 10% of the price offered, whilst scheduling the remaining 90% through installments over a period of ten years. Available estimates indicate that between 1993 and 1998, 44.3% of the total sales went to management-employee-buyer companies. Figures isolating such percentage for 1998 only, however, indicate a considerably higher percentage of 74.4%, which in 1999 dropped to 39%.

The Case of *Rodopa*

Rodopa – Shumen is one of three slaughterhouses in Bulgaria with an export license to the member countries of the EU (the other two are *Mecom – Silistra* and the slaughterhouse in Svishtov). In late 1998, the company had liabilities amounting to over $7 million, due the state budget, the United Bulgarian Bank and Bank Biochim. At that time there were two main players in the privatization bid for *Rodopa Shume*n – *Vanbouk* and the management-employee company *Rodopa – 97. Vanbouk's* bid was for $406,000 to be paid immediately in cash and *Rodopa-97's* bid was for $700,000 to be paid in cash over a ten-year period. However, when discounted with 10% for each year of the deferred payment period, the price offered by the management-employee company amounted to just under $300,000. Therefore the opportunity cost of the MEBO (the offer of $406,000) would have been too high.

However, this bid was submitted before the legal introduction of the discount procedure, which would have formally meant that the MEBO offer was more competitive. Thus the Executive Director of the Privatization Agency signed the contract for the sale of 67% of *Rodopa – Shumen* with *Rodopa – 97*. It is believed the signing of the contract took place only an hour after the members of the Supervisory Council decided to review the case at their next meeting, due to uncertainty concerning the origin of the management-employee company's funds. The above concerns were aired by a company closely related to the rejected bidder – *Vanbouk*.

There is awareness that MEBO's do not maximize fiscal revenues, tend to perform poor corporate governance, and actually embody politically acceptable means of liquidating public

enterprises. In fact, MEBO's often come into the picture when the firms involved have already accumulated losses that decrease the value of the assets and, therefore, lower the price of the sale and the expected revenues. Furthermore, the increasing number of MEBO magnifies some of the most powerful constraints on the pursuit of the Bulgarian privatization process: those built in the legislation concerning procedures for hiring and firing of management of State-owned enterprises management, as well as that concerning the appointment of members of the boards. Such collateral legislation enables the management of State-owned enterprises to obstruct privatization in various forms.

However, ultimately, even MEBO's may, at a later stage, turn into an economic opportunity to attract foreign investment and restructuring. A case may illustrate this. A state-owned copper-mine situated in central Bulgaria was sold to a MEBO company at a time when, after having been profitable for a number of years, it started losing market shares and producing losses.: in other words, when it would have been little attractive to a foreign investor and, at the same time, it would have required fresh capital injections to survive, which was precisely the requirement from which the MEBO was dispensed, given the preferential payment system mentioned above.

On the other hand, however, already at the time of the privatization deal, the MEBO Company had a contract with an Austrian steel concern concerning the latter firm's future investments in the mine, as well as the transfer of 90% of the company's shares. Notably, also at the time of the privatization deal, the government was aware of this contract that, presumably, was used submitted together with the privatization bid with the aim of reinforcing an otherwise less credible offer.

It cannot be excluded that, under those circumstances, the institution in charge of this particular deal tailored a two-stage privatization process that, whilst transferring responsibility for the firm, enabled to maintain consensus locally. Yet, it would exceed our argument to state that such strategy is deliberate in all cases of MEBOs of poor-performing firms. On the other hand, however, the example above demonstrates that, regardless of short-term objectives and effects of controversial privatization policies, even the mere transfer of property of State-owned assets may open new avenues for a market-driven economic system to, albeit gradually, take shape.

4. 'The devil is in the detail': issues arising from the sales procedures

Although, as mentioned above, existing regulation provides the legal framework within which sales procedures must be conducted, such regulation allows for the exercise of wide degrees of discretion in the selection of potential buyers.

Cash privatization, in particular, can be carried out according to different procedures: tenders, direct negotiations, public offerings of shares. Institutions in charge of individual privatization deals decide on a case-by-case basis which sale procedure to apply. Direct negotiation is the least regulated method and, yet, it is the most frequently used to sell government assets, at least at present[13].

[13] According to available data, in fact, the percentage of auction against the total number of deals contracted by both the Privatization Agency and line ministries in 1998 amounts to a mere 6%. It may be interesting to contrast this figure with those concerning the application of 'open' privatization procedures Hungary, where they account for nearly 70% of all the deals. See, Maria Dezserine, *Accessibility and*

Within the framework of direct negotiations, other than the sale price, the main criteria for selection of the offers are the commitment of potential buyers towards new investment and employment policies concerning the enterprise's workforce. In this respect, in the course of our fieldwork, we heard consistent complaints concerning the prioritization of such criteria, which is often seen as obscure and arbitrary, as well as about the lack of motivation of final deliberations. The issue is particularly salient for potential buyers; especially given the preferential treatment that existing legislation accords to management-employee buy-outs.

Share of "closed" and "open" procedures in the privatization of whole companies (all central privatizing bodies) 1 Jan 1993 – 30 Nov 1999

Procedure*	Share (%)
Open	7
Closed	93

* "Open" procedures are auctions and public offers; "closed" procedures are tenders and negotiations.
Source: Privatization Agency

We believe that "closed" procedures reduce the potential amount of privatization revenues, at least for the following reasons:

1) Trade-off between the price and the non-price commitments;
2) Unclear rules of procedure reduce the number of interested investors, which means lower demand and thus a lower price for the company;
3) Discretionary power, resulting from the unclear rules for buyer selection may, in certain cases, mean that the highest price offered is not the one selected.

Wide discretion in the implementation of sale procedures can also be observed with regard to the regime applied to the publicity of tenders and auctions. Particularly controversial appears the issue concerning the deadlines for submission of offers since the date of publication of privatization notices in the State Gazette. In this respect, we observed a striking mismatch between preferential deadlines accorded to offers from insiders, to which (on the top of the high rate of deals contracted with management-employee buyer companies) 20% of the assets of every State-owned enterprise for sale are reserved, as opposed to those applied to ordinary public procedures.

As for the former, standard deadlines of 90 days have been applied since 1995. As for the latter, completely opposite regimes applied in 1995-1996 as opposed to 1996-1997. On the one hand, in the first of the two mentioned periods, no deadline was mentioned in the notices. On the other hand, more recently, such deadlines have ranged between an average of 20 days, in 1997, and 30 days in 1998. Especially for the largest deals, such short terms make it virtually impossible to formulate informed, accurate and considered offers.

Drawing from the above issues, comments from our interviewees from the business community on the overall conduct of the privatization process, especially that concerning cash sales, recurrently pointed out poor business practices at the operational level and hinted at corruption at a more systemic level.

Transparency of the Public Procurement Process in Hungary, Albania and the Slovak Republic, Budapest, FME, 1998. See below part three for impacts on post-privatization and control procedures.

A different way in which this issue has been presented is that of the 'tactical' handling of information by different players. This is often rationalized based on the legalistic claim of the discrepancy between provisions on statistical data, which allow for confidentiality, and the privatization law, which would require openness. The resulting inaccessibility to relevant information affects the workings of privatization intermediaries - which, in principle, are agents of the government but, at times, are not informed of fundamental changes in the very firms which they are in charge of privatizing – and discourages potential buyers.

II. The role of the Core Executive in the Privatization Process

1. The political background: prolonged instability and changing priorities

Since the 1989 coup that led to the adoption of a new Constitution in 1991, and at least until mid-1997, the country experienced a number of weak and non-reformist governments and a prolonged phase of political instability. The latter phenomenon is clearly indicated by the fact that, during that period, the average life span of Bulgaria's transition cabinets has been less then 11 months. Since 1992 - the year of the adoption of the Privatization Law - Parliament has been dissolved three times and six different cabinets have taken office, including two interim governments and one cabinet of technocrats (see Exhibit 1 below). This is besides - sometimes-major - cabinet's reshuffling.

EXHIBIT 1 - SEQUENCE OF BULGARIAN CENTRAL GOVERNMENTS: 1989-1999

MONTH/ YEAR	EVENT	PRESIDENT	CABINET (PM)
11/89	**BCP Coup**	**Mladenov (BCP, BSP) 11/89-7/90**	**Atanasov (BCP) 02/87-02/90**
06/90	**Election of the Constituent Assembly – BSP wins**		**Lukanov (BCP/BSP) 02-10/90**
08/90	**Parliament appoints new President[14]**	**Zhelev (UDF) 08/90-01/92**	**Lukanov (BSP)**
12/90	**Coalition Government**		**Popov (unaffiliated) 12/90-10/91**
10/91	**General & municipal elections - No clear majority**		**Dimitrov (UDF minority government) 11/91-10/92**
01/92	**Presidential elections**	**Zhelev (UDF) 01/92-01/97**	
12/92-09/94	**Government of Technocrats**		**Berov (unaffiliated)**
09/94-01/95	**Caretaker cabinet**		**Indjova (unaffiliated)**

[14] Note that, following the 1991 Constitution, the President is directly elected by the people of Bulgaria.

12/94	**General elections - BSP wins**		**Videnov (BSP) 01/95-12/96**
10-11/96	**Presidential elections**	**Stoyanov (UDF) 01/97-present**	**Sofianski (UDF) 02/97-05/97**
02/97	**Caretaker cabinet**		
04/97-present	**General elections – UDF wins**		**Kostov (UDF) 05/97-present**

Legend

- Socialist
- Democrat
- Unaffiliated Prime Minister + socialists represented in the cabinet

Abbreviations

BCP – Bulgarian Communist Party

BSP – Bulgarian Socialist Party (renamed BCP)

UDF - Union of democratic Forces

Notably, until May 1997, with the only exception of the 11-month minority government led by the contending party, Union of Democratic Forces-UDF (11/91-10/92), the country was either ruled by socialist cabinets, or by different coalitions somehow involving socialists. In fact, until the 1997 elections only the socialists held majority seats in Parliament. On the other hand, however, the socialist party (BSP) has never had simultaneous control over the presidency, the legislature, and the executive.

In April 1997, for the second time since 1989, voters gave a full mandate to the UDF. This was following the failure of the socialist-led government in the field of economic reforms[15]. The newly elected majority took office in the spring of 1997 and announced a reformist program inspired to 'liberalization', dismantling of the old subsidies-based system, de-regulation of economic activities, and withdrawal from the State's overwhelming role in the economy. Since then, privatization has gained momentum. Indeed, most recently, Prime Minister Kostov placed emphasis on the commitment of the government towards privatization, stating that such commitment constitutes a requirement for members of the executive to maintain their positions. Not least, salary incentives have been set up to boost such commitment at lower levels of the administration.

Arguably, however, the macro-economic crisis confronting the country at the time when the government took office offered no alternatives to this approach. In fact, transitional assessments of the nearly two years of UDF administration confirm the increasing degree of commitment of the government towards privatization as a crucial dimension of the country's economic reform. However, they also stress the mismatch between the above-mentioned long-term objectives of the government and its short-term policies. These highlight a pronounced strengthening of the role of the State in the name of the need for 'emergency action', but also of more pragmatic objectives of self-preservation of the ruling political elite[16].

[15] This failure is clearly indicated by the fact that, in 1996, inflation rose to 310% (240% only in February 1997 and over 600% for the whole of 1997), the local currency was depreciated by 30 times and, between the end of 1996 and early 1997, almost twenty among the biggest private banks went bankrupt.

[16] See A. Ivanov (ed.), *Bulgaria 1998. The State of Transition and Transition of the State*, UNDP, Sofia, 1998, pp. 30-31. According to Luisa Perotti this confirms one of the paradoxes of privatization highlighted by Vincent Wright in his work on industrial privatization in Western Europe (See V. Wright, ''Privatizzazione Industriale e Bancaria in Europa Occidentali: Alcuni Paradossi', *Stato e Mercato*, 47 (August), 1996).

The government's instability is reflected in the alternating pace of the privatization process until 1997. Based on the number of privatization deals contracted between 1993 and 1998, in the following table we propose a collateral explanation of such alternating pace by placing emphasis on the diverse priorities of individual (sets of) government concerning the scope and speed of privatization.

Privatization deals before first years of the center-right cabinet

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*Total*
Total Number Of Privatization Deals	**62**	**165**	**309**	**515**	**590**	**1114**	**2755**
All Ministries	51	129	240	369	506	935	2230
Privatization Agency	11	36	69	146	84	179	525

Weak/unstable governments	**Socialist government[17]**	**Democratic government**
Political fragmentation **Need to deal with the sensitive problem of restitution**	**Voucher privatization** **Resistance to privatize large/ profitable firms and liquidate loss-making enterprise**	**Wide scope of privatization programme** **Sustained speed of the process** **Eclectic use of procedures** **Awareness of economic constraints**

1. Core-executive actors and institutions

There are four types of SOE's with four different types of government institutions acting as a principal: municipal, ministerial, privatization agency, and the cabinet. The latter is in fact responsible for the privatization of "natural monopolies", 21 of them being protected by the Constitution.

The following table shows the government bodies in charge of privatization and respective criteria of their involvement, as established by the Privatization Law and other regulations.

[17] It is important to point out that, towards the end of the 1995-1996 Socialist government, the privatization programme gained momentum. There appears to be a clear correlation between this development and upcoming deadlines concerning contractual obligations with international financial institutions.

PRIVATIZATION AGENCY	State-owned enterprises with fixed assets value higher than BGN 1 billion (as of 31 December 1997)
LINE-MINISTRIES AND COMMITTEES	State-owned enterprises with fixed assets value lower than BGN 1 billion (as of 31 December 1997)
MUNICIPALITIES	Municipal-owned enterprises
COUNCIL OF MINISTERS	"Natural monopolies" and enterprises assigned for "cash" (no debt instruments accepted) privatization (so-called "blue chips")
MASS PRIVATIZATION CENTER	Stocks in enterprises assigned for sale through centralized public tender against investment vouchers

Head of Government

A direct and active role of the Prime Minister is not provided for in either the privatization law or other related provisions. Furthermore, the responsibility to co-ordinate and monitor government's policies in the field of privatization are delegated to the Deputy Prime Minister in charge of economic reforms. However, its leadership is crucial to the outcome of individual privatization deals as well as to overcoming occasional but repeated lack of co-operation, especially at the cabinet level.

Drawing from a case in which it has been remarkably lacking can best highlight the importance of such expression of leadership by the Prime Minister. A case from 1994 provides an extreme example of this. Under the 'cabinet of technocrats' based on ad hoc parliamentary majorities that took office in late 1992, the Tourism committee (a government institution equivalent to a department although not headed by a member of the cabinet) challenged before the Courts the deliberation of the privatization agency to privatize major hotels in the country. This was in spite such authority had been entrusted to the privatization agency in the yearly government's programme. The Courts restated that the authority to allocate executive tasks to the privatization agency rests with the Council of Ministers. As a result, the Privatization agency only managed to privatise one large hotel in a list of over 100. Other than the weak status of the agency, this case illustrates that under conditions of political fragility of the government, line departments are in a position to obstruct the actual implementation of the formal allocation of responsibilities between the cabinet and the agency.

Council of Ministers

From a formal viewpoint, the Council of Ministers is responsible for decisions concerning the privatization of natural monopolies and for the approval of deals regarding a special list of companies[18].

[18] Other than in those instances in which the Council of Ministers is 'informally' involved in decision making concerning the privatization of given firms, according to an annex to the privatization program for 1999, the Council of Ministers is formally entrusted with the authority to approve privatization deals concerning a list of sensitive companies. This list comprises firms operating in various sectors (chemicals, metallurgy, food processing, the national air carrier Balkan Airlines, defense, the tobacco monopoly). In most cases (such as plants in the fertilizers' industry, an oil refinery, steel firms), these firms are in very poor financial conditions and face bankruptcy (Balkan airlines). Among the firms operating in various industrial sectors, some have either stopped production or operate at very low production capacity. Often times, their financial exposure is towards providers of public utilities, such as the gas and electricity suppliers. In the steel sector, negotiations are under way for the government to write off the firms' debts before privatization, and in some cases, attempted sales have thus far failed. No bidders are ready to buy these enterprises in this shape. Among these firms, even those which are in a somewhat more positive condition will require considerable technological investments as well as

Committee of Structural Reforms (CSR)
This consultative body, operating within the Council of Ministers, was established following the initiative of the then Deputy Prime Minister for economic reforms and industry Minister, Mr. Bojkov. Its main function of the Committee in connection with the privatization program is to design the government's strategy in this area.
Membership of the Committee is as follows: the deputy minister for economic reforms and industry minister (chair), the head of the Council of Ministers' Structural Reform Unit (secretary), the branch ministers involved in privatization, the Finance Minister, the Head of the Securities and Stock Exchange Commission, the Head of the Stock Exchange, the Executive Director of the Mass Privatization Center, the Executive Director of the Privatization Agency, etc.

The enlarged composition of the Committee is meant to ensure that this body serves as a consensus-building institution within the cabinet, as well as to facilitate the visibility of the position of the different departments involved in the privatization process. Yet, non-governmental actors do not seem to attribute any positive role to the Committee in fostering policy co-ordination in this area.

Privatization Agency
The agency is a separate institution attached to the Council of Ministers. Generally, it is responsible for the co-ordination of the privatization process and for developing the methodology of the process. End of 2000 – 2001 amendments to the privatization law contributed to the delusion of the responsibilities but would, perhaps, increase the role in the post-privatization. Its main role, however, is that of agent of the central government in the privatization process of the largest State-owned enterprises. The latter competence of the Agency is determined according to thresholds based on the value of the fixed assets of such firms. As indicated in the table below, since the first adoption of the Privatization Law, these thresholds changed twice.

Period[19]	**Value of the fixed assets, above which the company is to be privatized by the Privatization Agency**
June 1994 – April 1998	70 million BGN

investments to meet environmental protection standards (this is the case, for instance, of firms operating in the sector of non-ferrous metals). Between the better performing is the holding grouping Bulgarian tobacco plants. However, the sharp drop in exports to Russia and NIS might undermine its previous relative good standing. The list also comprises public utility providers, such as the Bulgarian Telecommunication Company (BTC), that will maintain monopoly over voice phone and underground cable communications until 2003. Unlike the previous case, BTC is considered a "blue-chip" and its sale is expected to bring big amount of cash to the government.

[19] It may be interesting to note that, between October 1997 and April 1998, there was a mismatch in the provisions concerning the thresholds. On the one hand, the Privatization Law postulated that the Privatization Agency should privatize all enterprises with fixed assets exceeding 70 million BGN. On the other hand, the same law also provided that other state bodies should be responsible for the privatization of enterprises with fixed assets below BGN 350 million. In other words, according to existing norms, it was unclear which institution would be responsible for the privatization of firms with fixed assets comprised between 70 and 350 million Bulgarian leva. This mismatch was overcome in April 1998, when the Law was, once more amended with retroactive effect to October 1997.

April 1998 – February 1999	350 million BGN
Since February 1999	1 billion BGN[20]

The Privatization law would appear to place the PA in a key position in the privatization process. However, its role as an 'actor' in such process is considerably constrained. The decision-making structure of the Agency, summarized below in schematic form, illustrates this.

	Supervisory Board	Executive Director
Tasks	• Approves the Statutes of the Agency • Approves the report and the agenda for the next year • Approves deals exceeding the threshold set in the Statutes • Appoints the chairman of the Board • Appoints the executive director	• Manages the activities of the Agency • Represents the Agency • Assigns other persons for certain activities
Composition	7 members: 4 appointed by the Parliament, 3 appointed by the Council of Ministers[21]	1 Executive Director appointed by the Supervisory Board
Mandate	Not fixed	Not fixed

Furthermore, the final approval of the major sales rests with the Council of Ministers.
Appraisers from (or appointed by the) Agency carry out the evaluation of enterprises.

Mass Privatization Center (and distribution of responsibility with the Privatization Agency when Mass Privatization is involved)

These two agencies are not bodies of the Council of Ministers, and their heads are not members of the Council of Ministers, but they are responsible directly to it

Steering Committees
Decision making responsibility for some major deals in privatizing monopolies is granted to *ad hoc* steering committees, e.g. in 1999 the privatization of Bulgarian Telecom is to be decided by such a committee which involves (head of PA, the minister of posts and telecommunications and two deputy prime ministers) [check the number of members and how established]

At the ministerial level[22]
Line ministries of Industry, Trade and Tourism, Finance (responsible for revenues, expenditures and budget (in cases of bankruptcy lists, enterprises isolated form credit), Agriculture, Construction, Transport, etc. The biggest owners were and still are the ministries of industry. But there are also some committees, i.e. structures with a rank similar to that of the Privatization Agency – bodies of the Council of Ministers but not members, (e.g. those of energy, and post and communications before end of 2000), which own and/or manage the biggest monopolies of Bulgaria. The Finance Ministry as a body responsible for the liquidation

[20] The exchange rate is BGN 1955.8 to the EURO. The thresh-hold has been changed three times (in June 1994, October 1997 and February 1999).
[21] The membership was reduced from 11 to 7 in October 1996, in 2001 the Parliament received the right to appoint more members, guaranteeing the presence of the opposition.
[22] At different stages of reforms there was a different constellation of players and responsibilities. The most important case was the establishment of the ministry of economic development, in 1995, which was overseeing privatization, banking sector, industrial and other ministries.

of loss making enterprises (a procedure which eventually leads to privatization).

Distribution of deals by ministries (by 1998)

Ministry	Other	Transport	Construction	Tourism	Agriculture	Trade	Industry	Total
n. deals	117	237	224	238	433	663	843	**2,755**
%	*4,2*	*8,6*	*8,1*	*8,6*	*15,7*	*24,1*	*30,6*	*100*

Parliament
Parliament is involved as an institution adopting the program. National Assembly, or the Parliament and its Economic Policy Committee, along with Budget and Finance Committee. Nomination of the Board of PA. Informal role of the MP's in privatization deals (especially MEBO's) is perceived as omni-present.

Local Level
Other than the central government level, privatization involves local governments (municipalities). These also operate through Privatization Agencies, for the bigger municipalities, or through municipal councils. No authority to decide upon the allocation of revenues.

Non-institutional actors
The most significant of them are:
- in the case of conventional privatization 30 "blue chips" of the Bulgarian industry are being sold by privatization intermediaries (the 'pools' structure);
- in the case of mass privatization: privatization funds competed to attract voucher of the public.

3. Patterns of continuity: an incremental and pragmatic approach towards privatization

Although the impact of the country's political instability in the years of transition on the alternating pace of privatization cannot be underestimated, with regard to the role of the core executive, an overall threefold pattern can be identified.

a) *Pervasive presence*
Formally or informally, the central government is closely involved in all stages of the privatization process: from the initiation, to the agenda setting, to the formalizations, to the implementation of privatization programs. This is certainly true of the main privatization deals. Among others, two examples illustrate this feature.

- As far as the institutional architecture of privatization is concerned, intermediary institutions (such as the central and local/municipal privatization agencies), are formally in charge of carrying out significant tasks in the privatization program. However, existing regulation actually places such intermediary institutions in the position of governmental agents with limited - or better, constrained - decision-making authority. Thus the core executive retains considerable authority and control over the conduct of the privatization process.

- As for the distribution of authority at the different levels of government, although the 'ownership' of enterprises is shared between the central and local governments (municipalities), local governments have no authority over the regulation of the privatization process. In particular, 'central' regulation extends to the allocation of revenues which, in all cases, is determined by the national Privatization Law and implementing provisions.

The 29 legislative amendments to the detailed provisions of the Privatization law since 1992 have not substantially altered either of the above features.

b) *Power v. Diluted responsibility*

At the same time as allowing for a large role of the core executive, the wide number of other institutional and non-institutional actors involved in the decision-making process, and possessing different degrees of actual decision making power, create a complex system of overlapping and often conflicting jurisdictions over individual privatization deals. The structure of authority is so designed that it, ultimately, results in the dispersion and dilution of political responsibility.

An example can better illustrate this pattern; in particular, that of the largest enterprises comprised in the yearly privatization programmes. In these cases, the ownership of enterprises and decision-making authority over the privatization process concerning them do not coincide. For instance, the Ministry of Industry may retain the ownership of a given firm; however, the central Privatization Agency and not the Ministry will carry out the procedure leading to its privatization: a distribution of authority that is provided for in the Privatization Law.

Yet, both on the basis of collateral legal provisions and informally, the Ministry's degree of involvement and control over such privatization could be very extensive. Not only it may be a 'counterpart' of the Privatization Agency by, for instance, being a member of the board of the firm to be privatized. Furthermore, internal provisions concerning the operation of the Privatization Agency, adopted besides the Privatization Law, may require the ultimate cabinet approval of the deal. In all cases, the executive 'controls' the operation of the Privatization Agency by appointing 4 of the 7 members of the Agency's board, which is also involved in decision making over the largest deals.

In other words, even when the general legal framework provides for the decentralization of authority, its implementation may lead to such authority being re-absorbed by the central government, although following complicated and obfuscated paths which often vary on a case-by-case basis.

As also mentioned above, the legal framework has repeatedly being amended since the first approval of the Privatization Law. However, such alterations have never substantially altered it in a direction that would make the link between actual power and responsibility more explicit.

There was a mood during the drafting and adoption of the privatization law that no single institution retained too much concentrated power and executive authority.

The fact that dilution of responsibility is, at the same time, a (political) resource, and a major constraint. Dilution implies that discretionary authority is exercised in different arenas and

requires extensive co-ordination.

c) *Incrementalism*

Multiplcation and juxtaposition of instruments and institutions. Many factors illustrate the continuity of the above two patterns.

For instance, since taking office in the Spring of 1997, the most recently appointed 'reformist' government, led by the UDF party (United Democratic Forces) was faced with the challenge of rationalizing the distribution of competencies within the central government. At that stage of the transition process, the political elite was fully aware that such rationalization was essential to boost the privatization program, to which the newly appointed government had declared full commitment.

Yet, the government did not undertake to re-allocate competencies and responsibilities in the privatization process. Nor did it rationalize, consolidate, or simplify procedural arrangements. For instance, besides further amending the Privatization Law, the government did not (propose to) alter the provisions concerning the duration of the mandate of the executive director of the Privatization Agency, nor to reinforce its institutional role. Nor has the nature of the institution been reformed. Although the creation of a separate ministry for privatization (such as in Hungary and Romania) was debated, the prevailing view was that reforming the role of the Privatization Agency, once the privatization programme was already well under way, would have required a major restructuring of existing administrations. The reallocation of responsibilities in 2000 – 2001 reflected pure political challenges before the government.

Thus, the government maintained the existing institutional architecture, while adding to an already extensive range of actors involved (in fact, of 'stakeholders'), a collateral policy making unit: the so-called 'Structural Reform Committee'. Similarly, it has maintained, re-applied, and only partially re-designed (in the case of 'mass' or 'voucher'-privatization) all the privatization procedures, which, at different stages, had been introduced and regulated by preceding governments and legislatures.

Conclusions

The research thus far conducted leads us to identify the following main features of the privatization process in Bulgaria.

After a decade of transition, a mismatch is apparent between, on the one hand, the government's changing rhetoric and policy-mix applied to privatization programs and, on the other hand, the fact that institutions and procedures, established over time to govern this process, have never been seriously challenged and substantially reformed or rationalized.

An overall incremental and pragmatic approach towards privatization has led to the consolidation of an extensive constellation of actors involved in the privatization process. This poses considerable problems of policy co-ordination, especially at the cabinet level and between the cabinet and the central government's privatization agency. This also creates overlapping jurisdictions over the implementation stages of privatization, which, in turn, result in the dispersion, and dilution of (political) responsibility for the same process[23].

[23] Although these features are most visible at the central level, responsible for the biggest privatization deals, they also apply at the local/municipal level and to the

The privatization process is underpinned by a very detailed and, yet, not comprehensive legal framework. In spite of a pronounced emphasis on minute regulation, existing provisions allow for wide discretion in decision making on individual deals. In the course of the interviews, private interlocutors of privatization decision-makers, in particular, recurrently lamented the opacity and lack of transparency of the process.

Throughout the various stages of the Bulgarian transition, contractual obligations with (that is, indebtedness towards) international financial institutions have been powerful catalyzers and determinants of the scope and timing of the privatization process. This was even when the government in power was less prepared to pursue privatization thoroughly.

It is, otherwise, difficult to identify a consistent driver of the privatization process, besides that of divesting of State ownership of economic activities without upsetting established constituencies. Even when proclaimed by the ruling political elite (such as under the current government), an ideological shift towards neo-liberal paradigms and a market-based and driven economic system is visibly mitigated by policies inspired by contingent needs, including that of minimizing the political risks of transition, which are often difficult to predict. Among other factors, the protracted resistance to privatize the largest state-owned enterprises, as well as the close, multi-form, involvement in the process of the management of the enterprises, clearly indicates this.

To conclude, looking back at the past decade, it appears that government's policies have not been driven by criteria of economic efficiency whilst, to an extent, preserving vested interests. However, there is little doubt that, in the long term, this scheme can hardly impede a structural transformation of the country's economic system. In other words, as mentioned with regard to the expected future development of some management-employee buy-outs, government's policies may, albeit intentionally, be functional to long-term change. This indicates that, in spite of its disjointed nature, the process of long-term economic transformation is irreversible.

III. Post Privatization Monitoring

1. Rationale

There are two factors to justify the work undertaken with this report: in 2001 starts the final stage of the privatization process in Bulgaria, and the diverse experience in terms of new economic players and their commitments introduced through this process.

Currently, Bulgarian privatization has reached the point of its evolution into completion stage. By the end of 2000 it was expected that about 2/3 of assets subject to privatization (i.e. all industrial and service sector enterprises, except those in the area of "natural monopolies", telecommunications, roads and railroads) would be sold to private owners, and this target was actually met.[24] In mid-end 2000, in relation to parliamentary and media debate on the future of

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relationship between the central and local governments.

[24] See: Privatization in 1999, Annual Report of the Privatization Agency to the Bulgarian National Assembly, February 2000.

the process and its institutions (Privatization Agency, line ministries, and municipal privatization agencies), the issue of the government role and its provisional monitoring tasks have been paid a great attention. The prevailing opinion is that needed amendments in the regulations should take place after a profound reflection on the accumulated experience.

2. Goals and topics

- A review of legal issues affecting the non-price conditions and commitments applied in privatization deals. This is especially in relation to the ways of selection privatization procedures and methods that imply application of the commitments.
- An assessment of the types of future commitments that have most frequently been included in privatization contracts. The presence of non-price requirements has been a widespread practice since the very beginning of privatization in 1993. The main motive behind the using the vast variety of future commitments is misperception among the government officials of the very concept of privatization. The acceleration of privatization substantially increased number of privatization contracts, which include future commitments. In addition to preparing and conducting sales, there is a need to ensure that there are enough staff and resources in privatization bodies to deal with the monitoring and enforcement of the contracts.
- A review of the institutional framework for post-privatization monitoring and procedures applied by the major privatization bodies. Even though the institutional set-up for post-privatization control became in practice in place, there is no appropriate regulations stating how and if at all privatization bodies should perform control functions. Besides, it creates contradiction between the role of the privatization bodies as governmental institutions, and as a part of the privatization contracts.
- An assessment of the system of the reporting on the fulfillment of the commitments, the enforcement of sanctions, and amendments to privatization contracts. A very introduction of the commitments to privatization contracts encourages privatization bodies to introduce special reports, verifying fulfillment of the obligations by the buyers. Breach of commitments in privatization contracts requires enforcement of sanctions. In order to avoid sanctions, the buyers, at least formally, can apply for re-negotiating and amending the privatization contracts.
- An assessment of the impact of the commitments undertaken by the buyers on the business strategies of the new owners and privatized companies. The new owners usually face the problems inherited by the privatized companies from the past, which require undertaking radical and fast restructuring measures. Many commitments impede process of restructuring of the privatized companies, and some of them could make it in practice impossible.

3. Post-privatization Legal Framework

Four of the privatization procedures, namely auction, tender, sale as per Art. 35, and centralized voucher auctions, receive specific regulation in ordinances. The ordinances focus on the basic features of the concrete privatization schemes. The two procedures, which allow for the

inclusion of future commitments, are the tender and the negotiations (no ordinance treats the negotiations technique). They are often quoted as "closed" procedures vs. the "open" procedures - auction and public offering.

The Ordinance on tenders[25] specifies the mechanics of selling state-owned shares in companies via competitive tender. According to the Ordinance the Decision for privatization via tender procedure[26] should include the *conditions* of the tender, such as:

- keeping the purpose of the object (i. e. the activity of the company) unchanged;
- keeping or increasing the number of working places;
- volume of future investments;
- saving and recruiting the environment;
- terms of payment;
- period, for which the new owner may not sell the object (i. e. the shares).

The Ordinance allows for the inclusion of additional conditions, as well as for the prioritisation of the conditions by the privatizing body.

Virtually no regulation (neither general nor internal for any of the privatization bodies) treats the *selection of procedure* by the privatization bodies. The Privatization Act says that state-owned shares in a joint-stock companies may be sold in any of the following 5 ways: auction, tender, negotiations, public offering, and centralized voucher auctions. Besides, state-owned stocks in a limited-liability company may be sold via any of the following 3 procedures: auction, tender, and negotiations.

4. Practices of the Privatization Bodies

We were convinced that the privatization authorities use a kind of matrix (although not formally approved, even not written) for the selection of procedure, which is the following:

- *Auction* is used for minority stakes in companies and detached units of companies;
- *Tender* tend to be used for majority stakes in companies with "clear files", which means no debts, no open court cases, etc.;
- *Negotiations* tend to be used for majority stakes in companies, which files are "unclear".

Exceptions are possible and we have visited companies, which files were not that "clean", but were privatized via tender. Also some of the negotiations are viewed as compulsory procedure when the company is "of structural importance". Besides, a shift from one to another scheme is possible, e. g. from tender to negotiations, during the privatization of a company.
The table in the first part that reflected the so-called open and closed procedures can be now redrafted in the following from, according to the used procedures.

Different procedures share in deals by November 1999

[25] Adopted with a Decree of the Council of Ministers No. 155 of 14 August 1992.
[26] The respective state body in charge of privatizing the company issues the Decision.

Procedure	Share (%)
Auction	6
Competitive tender	43
Direct negotiations	42
Sale as per art. 35 (without tender or auction)	8
Public offering on the stock exchange	1
Centralized auctions	0
TOTAL	*100*

Source: Privatization Agency

Tenders and negotiations, i. e. procedures that allow for inclusion of non-price future commitments, have been and still are prevailing in the practice of privatization bodies (see tables above). Main feature of these techniques is that the ranking of offers is made according not only to the price, but also to the evaluation of the business plan, which every candidate is due to submit. The business plan has usually a complex structure, which main components are the employment and investments in the projected period. Thus, the number of criteria for buyer selection is more than one, unlike the auction where the price offered is the only criterion.

The Case of *Chimko*

Privatization of the fertilize producer *Chimko* commenced in 1997 when the South Korean *Daewoo* and the American *Stellar Global* companies showed interest in the company which at that time was a profitable concern. *Stellar Global* offered a higher price - $100.2 million. According to the Privatization Agency, the negotiations with *Stellar Global* were halted due to the fact that the company was facing financial problems, which led to a delay in the privatization process. However the procedural delay itself led to a deterioration of the plant's financial position, which resulted in a drastic fall in the selling price.

In the period 1997-1999, *Chimko's* liabilities increased due to higher gas prices. In 1998, new negotiations were opened, when the minimum price was $38 million, but no buyers appeared. A year later, a new negotiation was opened. *IBE – Trans* of New York and *BTC partners* registered in the British Virgin Islands submitted their offers. The Privatization Agency chose *IBE – Trans* and in July last year, a privatization contract was signed. According to the contract, a price of DM 1 million had to be paid in and $50 million had to be invested over a period of 3 years. The old liabilities of the company (mainly due the state-owned gas supplier *Bulgargas*) amounted to DM 70 million. The company's debt decreased to about DM 54 million after the state waived the forfeits.

Thus for a period of two years, the effective price (revenue plus liabilities) of *Chimko* fell from $100.2 million to DM 55 million. At the same time the actual proceeds to the budget were only DM 1 million (down from $100.2 million).

The Case of *Vinex*

Vinex – Preslav, one of the largest white wine producers, was privatized in late 1999 after three unsuccessful privatization procedures in a row. In the fourth procedure, two candidates appeared – a former privatization fund *St. Sofia* and a Bulgarian company named *Perinea.* The selected candidate was *St. Sofia.*

However, according to the rejected bidder, *Perinea's* offer was a higher price. According to Borislav Banchev, owner of *Perinea*, the company offered a price for the majority of the shares amounting to

USD1.71 million and proposed a commitment to invest USD5.5 million. According to Mr. Banchev, at the beginning of the bid procedure, his company offered USD1.1 million while the price offered by *St. Sofia* was even lower. In the first phase of the negotiations, both companies offered higher prices but the negotiations were terminated.

The fourth privatization procedure for *Vinex* attracted more bidders than those previously held, probably due to the considerable reduction in the minimum price. During the first two privatization procedures, there was no investor interest and in the third bid, only one offer was submitted by a management-employee company. Two years ago, the starting price for the majority of the shares was approximately USD10 million, whereas the last procedure involved no such fixed price. Last summer, the condition imposed on the bidders was for them to pay a minimum $1.9million and at that time, only a management-employee company submitted an offer, which later proved to be incomplete and thus the whole procedure failed.

The current buyer had good a chance from the very beginning. Since October 1998, the Executive Director of *St. Sofia*, Borislav Manachilov has been a member of the *Vinex* Board of Directors. He also figured in the management of the management-employee company that had participated in the previous procedure. Therefore, it is no surprise that *St. Sofia* won the bid so easily.

As in most of the cases, the delay in privatization led to deterioration in the financial performance of *Vinex*. After all, the plant is not such a large debtor – it owes the state budget 1.5 million BGN and if we add the dividends, corporate income tax etc. due the state, the total liabilities add up to some USD 2 million. Although *Vinex* has current liabilities due *Reiffeisen Bank* and *United Bulgarian Bank*, it is repaying these regularly. In the period 1997 – 1998, the company was in good financial standing and had a BGN 1.26 million and BGN 0.4 million profit respectively. Since the end of 1999, the financial condition of the company has deteriorated and it is now believed to have shown a loss of BGN 0.2 million.

Analytical Remarks

The Ordinance on auctions[27] postulates that the *selection of buyer* by privatization via auction is made only on the basis of the price offered, eliminating the discretion of the public officials. However, no clear rules for buyer selection are outlined in the Ordinance on tenders, where Article 11 states that "the selected buyer should be the one, whose offer best satisfies the tender conditions". No such rules can be found also for the direct negotiations as no specific regulation treats this procedure at all, making it the least regulated, respectively the most highly discretionary.

As no formal rules define the principles of the *selection of procedure* the choice of privatization scheme is entirely dependent on the personal discretion of privatization bodies' officials. The main motive behind the prevailing use of "closed" procedures is that, according to the privatizing authorities, they allow for the better selection of buyer, because the evaluation of different offers is made on the basis of more than one (the price) criterion. Also the "closed" privatization techniques as a rule require the commitment of the new owner regarding at least the working places and future investments, which means a period of post-privatization control over the already privatized company. As one of the public officials stated it "the privatization is not just a sale; it aims at the development of the given company."

[27] Adopted with a Decree of the Council of Ministers No. 105 of 15 June 1992.

Obviously the weight of the selection criteria, when tender or negotiations schemes are used, varies by the privatization of different companies. In the Decisions for privatization usually these criteria are quoted in two groups: priority and other criteria. Nevertheless, the practice for announcing the exact weight of each criterion by the offer evaluation is rarely met.[28] The results of this vicious practice are:

- Privatization procedure loses its transparency;
- Candidates are led into a blind competition, which forces them to submit business plans (i. e. future commitments if they buy the company), which are hardly achievable.
- Differences in the access to information for insiders and outsiders occur.

5. Types of Future Commitments

In the general case privatization contract includes two type of obligations for the new owner: 1) the price and the conditions of payment, and 2) all other obligations, named in this report "non-price future commitments" or "non-price obligations". The non-price obligations can be divided into two subgroups, namely financial (such as the investment program) and non-financial (such as the working places). In the section below we focus on the non-price future commitments, as they are a necessary condition for the post-privatization control itself.

Generally Applied Commitments

Several types of non-price future commitments were common for all the companies that we visited, regardless the type of procedure (tender or negotiations) and the type of buyer (management-employee company or another type of domestic investor, or foreign investor). These are the following future obligations:

- *Maintaining a certain average number of staff*
- *Certain volume of investments*
- *Preserving company's previous activity*
- *Keeping stake of the new owner unchanged*
- *Environmental protection*

The period, for which the commitments are due to be met, was in all companies visited 5 years after signing the privatization contract. The only exceptions were two deals with foreign investors, where the obligation for keeping the new owner's stake equal or above 70 % was applicable only for 3 years.

The *employment* commitments concern the average number of staff in the future period, as well as in certain cases the level of wages. As the average number of staff is one of the components of the business plan submitted by the candidates, it becomes future obligation when the buyer is selected. The most frequently met cases among the deals of PA and MI are the obligations for keeping or gradually increasing the average number of staff. Obligations for keeping the average number of staff below the pre-privatization levels are exceptions. The period, for which that type of commitment is applicable, is obviously 5 years for the PA, and between 3 and 6 years for the MI. In some cases the average number of staff for the whole period (5 years) should be observed, and in others it is the average number of staff for each year of the 5-year period.

[28] We were told that the MI announces the weights to the candidates but this practice is quite recent.

The business plan consists also of a time-schedule and types of the *future investments*. After the buyer is selected the volume of investments of his business plan becomes one of the future commitments. Sometimes the proposed time-schedule of investments is included in the privatization contract, which specifies the volume of investments for each of the following 5 years. In one of the companies visited the types of investments (certain tangible assets) were included in the investments time-schedule. Prior the beginning of 1997, when a the economy suffered a hyperinflation shock, it was possible to contract the investments in either domestic or foreign convertible currency.

Total Volume of Investments Committed (in the deals of all privatization bodies)

Year	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999***	**Total**
m USD	59	202	152	171	891	389	781	2 645
% of total financial effect*	45	46	46	29	59	38	52	48

*First seven months.
*Total financial effect includes cash payments, liabilities undertaken, and investments committed.
Source: PA

Besides, all the new owners that we visited were obliged to keep the *scope of activity* of the privatized company. Also a standardized clause to *protect the environment* according to the environmental laws was included. Finally, all new owners had to keep their *stake* in the privatized companies equal or above the per cent, which the privatization contracts were for.

Specific Types of Commitments

Besides the generally applicable commitments we learned of a number of specific non-price future obligations. Some of them were applied to a limited number of deals, others, however, are common for a large group of companies, which have a common feature – e. g. the repayment of debts is included in all contracts for indebted state-owned companies. The following list of specific commitments is obtained from our interviews in 11 companies and is not exhaustive, but gives clear picture about the variety of post-privatization obligations:

- *Repayment of debts*
- *Preservation of trade marks*
- *The minimum wage in the company should not fall below certain level*
- *Maintenance of the state reserve and the war-time stock*
- *Ban on capital increases*
- *Ban on company's legal liquidation*
- *Ban on sale of the new owner's shares*
- *Ban on the sale of long-term tangible assets*
- *Obligation to stick to the contracts, signed before privatizing the company*
- *Obligation to satisfy additional restitution claims*

The usual periods for such commitments are 5 years. However, when the new owner is a management-employee company a 10-year period deferred payment of the price is possible. When such a scheme is used the shares in the company are used as collateral of the payment before the respective privatizing authority. This makes the ban on the

sale of share valid for the period of the deferred payment, which could be up to 10 years.

Usual Periods Applied to the Future Commitments

TYPE OF COMMITMENT	USUAL PERIOD
Generally applied commitments:	
maintaining a certain average number of staff	5 years
investments	5 – 7 years
preservation of company's previous activity	5 years
keeping the stake of the new owner unchanged	3 – 5 years
environmental protection	5 years
Special commitments:	
the minimum wage in the company should not fall below certain level	5 years
repayment of debts	Depending on the credit terms
preservation of trade marks	5 years
maintenance of the state reserve and war-time stock	5 years
ban on capital increases or decreases	5 years
ban on company's legal liquidation	5 years
ban on sale of the new owner's shares	5 years
ban on sale of the long-term tangible assets	5 years
obligation to satisfy additional restitution claims	not fixed
obligation to stick to the contracts, signed before privatizing the company	Term of contract

A milk-product company, located 130 km away from Sofia, was privatized via negotiations. The new owner, a management-employee company, decided to use the 10-year deferred payment scheme. One of the future commitments that the buyer undertake for the following 10 years was to create a gas installation in the plant. However the city, where the plan is located, has no gas transmitting network, which makes the creation of a gas installation senseless.

Analytical Remarks

There is a prevailing among the privatizing bodies' officials perception of privatization as a process, which aims at *developing the company*, i. e. their job is not just transferring the property, but also finding the "good" new owners and having them committed to "develop" the companies. This naturally leads to the vast variety of non-price future obligations. The preservation of company's previous activity guarantees that the company will continue its operation. This commitment is often combined with a ban on company's legal liquidation.

"We insist on investments when the company's equipment is very old, and the company is not competitive"- shared with us one of the public officials. Obviously the privatizing authorities consider investments the primary source of companies' development. In the preliminary evaluation[29] of the company (which is due to be made before the offers are submitted) a

[29] Experts approved by the respective privatizing body make the preliminary evaluations. According to the privatization Act such valuation is obligatory when the procedure is negotiations (including

minimum volume of needed investments is included, which becomes a reference threshold by the evaluation of offers. In certain cases even specific machines and equipment are included as commitments in the privatization contract in order to confirm that the buyer has actual intentions to invest.

Behind the employment related commitments only social reasons – i. e. the high level of unemployment - were mentioned. However this commitment is persistently present in contracts for companies located in regions with negligibly low level of unemployment, e. g. Sofia city. Also it is not clear why in certain cases the employment commitments touch the issues of wages and collective labor contracts. Although we are not aware of any direct pressure imposed by the trade unions upon the privatizing bodies, the privatizing bodies' officials claim to be "a kind of buffer in the policy conducted by the government."

Keeping the majority stake in the hands of the new owner is a necessary condition for the post-privatization control, i. e. the undertaking of whatever commitment before the privatization bodies imposes at least this additional commitment. In a bulk of privatization cases, both management-employee buy-outs and deals with outsiders, this future engagement was combined with one or more of the following commitments:

- ban on capital increases or decreases;
- ban on the sale of the new owner's shares;
- ban on using the shares as collateral.

The ban on the sale of new owner's shares is, according to the Privatization Act, applicable to all cases of management-employee buy-outs on deferred payment. In such cases the management-employee company is due to secure the payment using collateral or mortgage. The recent practice of the privatizing bodies shows that the shares, as well as the long-term tangible assets in the privatized companies, have been used as collateral. This has naturally imposed 1) the ban on selling or using as collateral new owner's shares, and 2) the ban on the sale of the long-term tangible assets.

Regarding the preservation of trademarks, public officials in the PA convinced us that this commitment was imposed only upon the buyers of the state-owned breweries. The motive behind it was preservation of domestic beer market from monopolization. The fear of the privatizing authorities was born from the fact that several breweries, holding different trademarks, were bought by one and the same foreign beer producing company, which could have substituted the several different marks with one common trademark.

Maintaining the wartime reserve is a commitment, which is extracted from the legal framework treating military issues.[30] The companies with such a commitment is due to maintain certain quantities either of the inputs they use, or of their produce. Commodities, which were mentioned as part of the wartime reserve, include: sugar, oil, salt, tin, etc. Since the regulations treating the wartime reserve are secret, we could only doubt whether such clauses in the privatization contracts repeat or complement the general legal regulation of the issue.

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negotiation as per Art. 35). Obviously the insiders could influence this preliminary evaluation since they provide the primary data for it, however, this is not the focus of the current research.

[30] It is probably regulated in The Ordinance on the state reserve and war-time provisions (adopted with a Decree of the Council of Ministers No. 315 of 24 December 1998), which contents are secret.

The environmental protection commitments seem to be present in every privatization contract either as concrete engagement (e. g. building a water-cleaning station) or as standard abstract clauses, which state "protecting the environment according to the environmental laws". In the privatization authorities we were told that the standard clauses for environmental protection are put in the contracts "in order to remind the buyer to respect the environmental laws". This kind of clauses that merely repeat a general regulation, we do not consider privatization commitment clauses, which might be the case also with the war-time-stock clauses.

6. Post-privatization controls

Institutional Framework and Practices

Privatization bodies maintain specialized control units. In the Privatization Agency (PA) there is a "Coordination and Control of Privatization Process" department. The Ministry of Industry (MI) has "Privatization" department with a specialized "Control" unit. The "Control" department of the PA consists of 9 people, while the "Control" unit at the MI employs 13 people.

Privatization control is conducted according to a methodology of the PA, which is an internal document, issued as order by the Executive Director of the Agency[31]. The first methodology was approved in 1995, and now the Supervisory Board of PA has just recently approved a new methodology. However, PA representatives claim that their department has been working with the new draft methodology for over a year. As government body, which should provide methodological guidance to all other privatization bodies, the latter are generally using the same methodology.

The number of privatization contracts that are monitored by PA is about 430, and those monitored by MI - about 650[32]. Given the average size of a company report of about 100 pages (together with all required copies and attachments) it seems that control units are overwhelmed with work.

In both privatization bodies we studied experts from control units participate in preparation of the deal. They check all draft contracts and work on the provisions that they will have to monitor later. This is called "pre-privatization control". The PA representatives claim that they make corrections in 90% of the draft contracts. They also claim that PA follows standard provisions on non-price future commitments of buyers that would allow more efficient control. On the other hand, PA representatives generally admit that the pre-privatization control in the other privatization bodies is inefficient which undermines future control efforts.

The new buyer becomes a party to the contract; the buyer is therefore responsible for the fulfillment of all obligations as of the contract. On the other hand, the non-price commitments actually refer to the way the privatized company is being managed, and the fulfillment depends to the economic performance of the latter. Therefore, the privatization bodies in fact monitor the performance of the former state-owned company, while at the same time keeping

[31] For the time being, IME is refused access to this methodology.
[32] According to representatives of PA and MI

responsible the new owners. This seems to cause some misunderstanding among both privatization bodies and the new owners.

No law provides that companies (and buyers, in fact) should disclose information to the privatization bodies after privatization. The Statistics Law provides that companies are obliged to provide statistical information to "statistical agencies" only when the data required is explicitly enlisted in the Annual Program of Statistical Surveys. Nor does the Privatization Act require any type of reporting by privatized companies.

On the other hand, standard privatization contracts require companies to send reports to privatization bodies on annual basis. Also, we found in most contracts a standard clause that "the buyer is obliged to provide access to all necessary data needed by the seller". At the end of each year privatization bodies send individual letters to companies to describe required reports. The PA uses 4 different sample letters depending on types of commitment in each individual contract, while the MI sends uniform letters for all companies. These letters include deadlines for submission of reports, a list of reports to be provided, a list of documents that should be copied, and contact persons at the privatization body. A spreadsheet on investments to be filled by companies is attached to the letter.

The standard deadlines for submission of reports are either 31 January, or 31 March of the following year. As the standard letter sent by the MI reads, the deadline at the MI is 31 January. Since the PA requires also accounting reports, which according to the Accounting Act are due March 31, the deadline for these documents is apparently 31 March. At the same time, companies privatized prior to 31 December 1997 enjoy 5 year corporate tax preference (see section on reporting requirements). The tax office requires a verification document by the privatization body that obligations related to employment and investment laid down in the contract are fulfilled. Since the annual tax return is due March 31, companies that enjoy that preference should obviously send reports on employment and investment by 31 January in order to receive verification by the seller.

PA seems to be involved in the very process of preparation of reports by companies. According to the head of the PA "Control" department, experts from the department help some managers to compile the reports. The reason seems to be the vague definition of "investment". The Foreign Investment Act provides a comprehensive definition for foreign investment; on the other hand the PA considers the provisions in the Accounting Act insufficient. Therefore, PA itself provides a definition of what investment is for the purpose of privatization contracts. Moreover, contracts signed by 1994 had different wording of employment obligations, i.e. "new jobs" instead of the present expression "average number of employed".

Once received at the privatization bodies, the respective "Control" departments check reports. Priorities for control are, first, making sure that reports are complete, and second, issuing the documents required by tax office for tax exempted companies. At the PA experts make arithmetical checks of correctness of calculations based on attached copies of invoices or other documents.

Site audits are made rarely; we recognized in both privatization bodies and interviewed companies. The PA makes inspections under three major preconditions: in big companies where both size and variety of investments is huge; in case it is notified by a third party (including labor unions and press); in case the report is missing or is uncompleted. The MI

makes site audits in case the report is missing or uncompleted. The MI "Control" unit makes about 5 to 6 site audits per annum. The discretionary power of privatization bodies to initiate site audits therefore is substantial.

Interviews with companies provided no evidence on how privatization bodies decide to go for a site inspection. Out of 11 companies, 3 reported to have been visited by experts from the respective "Control" departments. Two of them are located in Sofia. One of them, owned by a foreign investor, was visited once for approval of investment equipment. No amendment has been signed. The other has been visited 5-6 times by representatives of MI during the last two years. The company has negotiated one amendment for reduction of employment. At the same time, the privatization of the company had been problematic: the present owner - a local investor - won the negotiations in 1993, but the Ministry of Industry refused to transfer the ownership. A second procedure - competition - was opened and in 1997 the same buyer won again. The roots of the scandal remained unknown to the authors; this very fact however, might be the reason for the frequent audits. The third company - owned by the management-employees company - that reported site inspections is located outside Sofia. Three audits have been made by the PA, one of them directly related to amendment of the employment obligations.

Specific type of site audits is conducted in big companies with huge investment commitments. PA pointed to one case where the foreign investor had commitment to invest over DEM 30 million in 5 years. The number of separate investments was huge, therefore the PA did not require copies of all invoices and documents but only for the considerable amounts, together with a list of the remaining. Then a group of control experts went to visit the plant and made random checks of the equipment mentioned in the list.

After reports are received and reviewed by "Control" units at the privatization bodies, the latter send warning letters to the companies that failed to meet the obligations. These letters acts as formal notification that the company should pay sanctions. Standard privatization contracts read, "Sanctions are due in 30 days after the seller notifies the buyer".

If a buyer fails to pay the sanctions as provided in the contract, the PA files a court claim against the debtor. At present, PA has 40 files at court. The head of the "Control" department complained they have no flexibility imposing the sanctions. The Accounting Chamber is closely monitoring their activities and does not allow the PA to relieve or delay imposition of sanctions or court claims. On the other hand, the Ministry of Industry does not have a single court claim. It might be either because all companies are fulfilling their obligations (or pay sanctions on time) or because of lack of internal control by the Chamber of Accounts.

Analytical Remarks

The very idea of privatization control was "spontaneous" invention; there is no single legal provision reading that privatization bodies should execute control functions. The basis of privatization control is the Contracts and Obligations Law, in other words, the general civil law. Thus the state via the PA and other privatization bodies turns into mere party to bilateral contract. Therefore, no limits to administrative power are possible; privatization bodies can establish the rules of the game, the procedures, the sanctions, such as any individual party to contractual agreement can do. Privatization control is also an example of mutual self-creation

of administrative authorities. The Profit Tax Act of 1996 established tax preferences for newly privatized companies that were applicable only for those holding a certificate by the privatization bodies for fulfillment of privatization contract. This is a *prima facie* argument for the existence of privatization control.

The reporting requirements for buyers are a perfect example of self-perpetuating administrative discretion. As a standard clause in contracts stands "the buyer is obliged to provide access to all necessary data needed by the seller". Then the privatization bodies have the absolute power to establish what information companies are bound to send. This is a formal excuse for privatization bodies to require whatever documents they see fit (see section on reporting requirements). We recognized for example that PA requires a copy of the annual accounting report, and the MI does not. Moreover, reporting obligations pretended to be founded by the contractual obligations between the buyer and the seller, and not by any superior position of the privatization bodies. In other words, buyers are not "forced" by the government institutions (sellers) to report, but rather they have "voluntarily" agreed to do so by signing the contract. If privatization bodies believe they need a specific report to verify fulfillment of obligations they can explicitly mention this report in the privatization contract. Each deal establishes concrete commitments by the buyer; therefore, reporting requirements can be projected in advance. Also, it remain unclear why the privatization bodies would require information already collected by other government institutions. PA for example requires annual accounting reports, which seems quite strange since they cannot verify the fulfillment of any obligation, and on the other hand the National Statistical Institute already collects them.

The above-mentioned observations question the ground for the very existence of privatization control. The idea that a government institution must have a veto on investor plans for the following 5 years lacks any economic rationale. Understandably, the legislator has provided no explicit provision that would allow privatization bodies to monitor the performance of privately owned companies. The "invention" of privatization bodies to organize post-privatization control therefore might be explained only by their strife to maintain state interference in the economy.

On the other hand, many still believe that the market and the private entrepreneur cannot be trusted in. This belief generally suggests that unless the government makes sure that companies are "properly" run, the private investors will lead them to bankruptcy. It is not here to discuss a claim that has never been proved by either economic theory or practice in the real world. But the facts prove that privatization control fails to serve this goal, it does not in fact monitor whether companies are properly managed. It is an impossible task *a priori*, it will require a new *planning committee*. The observations below prove that the actual activities of the privatization bodies are mostly concentrated in following the administrative procedures, doing the paper work correct, and "waive the stick" when an investor tries to behave not in line with the political mood of the day.

Ambiguities stemming from unclear definitions of "investment" and "new jobs" create reporting problems; there were enterprises, which underreported investment due to lack of understanding. The general practice of the PA in such cases is to contact the management and to go through the documents once again. In numerous cases, PA representative claimed, "companies didn't know what exactly is considered investment". There were isolated cases that experts from the PA worked together with the company management to prepare the reports. No

rational reason would make a bureaucrat do excessive paper work other than create importance of his position.

Moreover, problems can hardly be blamed on institutional chaos. In general, the institutional set-up for privatization control seems already established. This is far from saying that control departments do a perfect job; it rather means that it is at least clear who is responsible when privatization contracts are to be monitored. Also, the staff of "Control" department in PA remained unchanged under the rule of 4 executive directors. Since the PA is relatively new institution with new functions, the current staff actually participated in the very design of privatization control. No complaints for lack of qualifications can be justified.

As mentioned earlier, the average size of a report submitted to the PA is about 100 pages (the size pretty much depends on the number of documents and invoices copied). There is no evidence that in other privatization bodies the reports are shorter. According to the head of the PA "Control" department, these checks eat up almost entirely the time of the department. At the same time, the head of the MI "Control" unit complains of permanent inquires by the National Statistical Institute which need huge efforts and time. The overall impression is that the privatization bodies are overwhelmed with paper to audit, and given the limited human resources the control remains formal, i.e. the numbers are checked for arithmetical errors rather than for economic rationality.

Privatization control therefore turns in mere formal procedure and a possible tool for harassment when needed. Site audits are rare, most reports are collected and stored for evidence, and only total numbers are checked for reconciliation. Sometimes controlling agents help companies prepare the reports. It turned that control procedures *per se* do not cause excessive burden for companies. Moreover, it seems that reasonable applications for amendment of contracts might come to success. Therefore, privatization control cannot ensure perfect execution of all contracts; it cannot also stop lay-offs if business conditions require it. The only function it rests with is a tool of the government policy for intervention in economic affairs; a tool in the *sticks-and-carrots* game.

7. Reporting Requirements

Documents Verifying Fulfillment of Commitments

The privatized companies submit reports to the Privatization Agency (PA), respectively to the Ministry of Industry (MI), once a year. Usually, the reporting period for a given year ends by 31 January, or by 31 March of the next year.

There are exceptions to the obligation for annual reporting to the privatization authority. For example, the privatization contract for one of the surveyed enterprises, which buyer is a big foreign company, stipulates that reporting fulfillment of the commitment for investment should be ***twofold*** in a span of five years. According to the contract, investments should be done in two tranches. The reports are to be submitted after accomplishing each tranche, and not as in the common case - annually. The management of the enterprise in question does not submit any other reporting documents to the Privatization Agency. The privatization contract of another company stipulates, that besides annual reporting to the Privatization Agency, verifying fulfillment of investment program and other commitments, the company should submit average number of employees report ***each three moths***.

Except from the reporting documents defined in the privatization contract, the companies are obliged to submit extra papers, requested by special letters from the PA or MI.

The reporting requirements concern the buyers. Duration of reporting before the privatizing authorities is defined in the privatization contract and usually coincides with the terms of fulfilling assumed non-price obligations. In most of the cases this period is 5 years. When the employees buy the given enterprise and the legally set preferential terms of payment are applied, the period for paying off the company, respectively reporting is 10 years.

In one of the surveyed enterprises, the buyer (MEBO) has paid up the price contracted for 11 months instead of the envisaged 10 years. Nevertheless, the buyer is to report along the whole period of 10 years.

Documents verifying investments absorption:

- Report of committed investments. There is a standard form, which includes numbers and dates of invoices, suppliers and/or executors, contents of deliveries and/or installation works, etc.
- Certified copies of all primary accounting documents - invoices, standing orders, customs declarations for consigned investments directed for fixed assets, bank statements, etc.
- Certified copies of all documents related to the investment program contracts, protocols, Act 19 (for carried out installation works and for site' value), etc.
- Declaration as per § 9 of the Temporary and Concluding Provisions of the Privatization Act. This actually means that enterprises should declare origin and grounds for investment funds ownership, as well as to submit a Declaration of taxes paid.

When investments are in the form of big machinery and equipment, deposited in the enterprise capital, their value in increased capital is assessed according to conclusions of experts appraisal. In this case, there are few more documents to be submitted:

- Experts Appraisal of the investment performance, certified by three experts.
- A Court Order approving the Experts Appraisal.
  Except from the above-listed documents evidencing commitment of investments, whereas the specific investment is a-ported in the company's capital, added is:
- Declaration of non-disposal with fixed assets imported in the company's capital.

Documents, verifying retaining business activity

Most of the enterprises sent to the PA (respectively to the MI) a ***Declaration of retaining business activity***, signed by the Executive Director of the company. Other documents that are obligatory, and having power of proof are:

- Copy of the last court registration.
- Copy of the Certificate for the company's Current (Legal) Status.

Documents, verifying retaining number of employees

Retaining the average number of employed is proved by an ***Average Monthly Number of Employees Report*** for the specified period. This report follows a standard form and is certified in the respective regional bureau of the National Statistics Institute.

Documents, verifying retaining of stocks and shares ownership

- Copy of the Shareholders Register (applied for the joint-stock company).
- Declaration of retaining Lots of shares (applied for the limited-liability companies).

Documents, verifying fulfillment of conservation of environment obligations

In fulfilling the regulatory requirements or assumed with the privatization contract obligations for conservation of the environment, the enterprises add an appraisal from environment experts in the form of

- a Protocol or written Statement of the Regional Inspectorate for Environment and Waters Protection (RIEWP).

Accounting Report

Apart from the enlisted above documents, proving fulfillment of the non-price commitments assumed with the privatization contract, most of the companies submit to the PA the following accounting reports:

- Balance Sheets and respective annexes (e.g. references on fixed assets, on receivables, liabilities and loans, financial assets, etc.).
- Income and Expenditures Accounts and respective annexes (reports on cash-flow, on equity, on employed and wages, etc.).
  Companies where annual reports are verified by a Certified Public Accountant have to submit before the PA (respectively the MI) an
- Auditors Report from a Certified Public Accountant.

Other specific documents:

In some cases, apart from the standard documentation requested by the PA and the MI, some privatized companies must submit other papers and declarations reporting specific obligations assumed with the privatization contract. Thus, some enterprises send to the PA a *Manufactured Output Report*. In other cases, additional documentation requested includes duplex declaration of other submitted reporting documentation.

These specific documents are:

- Declaration, verifying fulfillment of non-price commitments included in the privatization contract.
- Declaration of legitimacy of data enclosed in the Yearly Report. This declaration is standardized and is sent by the companies to the PA.

DOCUMENTS VERIFYING FULFILLMENT OF NON-PRICE COMMITMENTS

Verifying:	***Reporting documents:***
Investments	▪ Record of investment expenses committed; ▪ Certified copes of invoices, standing orders, customs declarations, etc.; ▪ Certified copies of Contracts, Protocols, Act.19; ▪ Declaration of origin and grounds for ownership of invested funds; ▪ Declaration of taxes paid; ▪ Experts Appraisal of the investment performance, certified by three experts; ▪ A Court Order approving the Experts Appraisal; ▪ Declaration of non-disposal with fixed assets imported in the company capital (aport installments).
Company's business activity	▪ Copy of the last court registration; ▪ Copy of Current Status Certificate for the company.

	▪ Manufactured Output Report
Average number of staff	▪ Average Number of Employed Report for specified periods.
Retained ownership on stocks and shares	▪ Copy of the Shareholders Register; ▪ Declaration of retaining Lots of shares.
Environmental protection	▪ Protocol or written statement of the RIEWP.
General fulfillment of the non-price commitments	▪ Accounting Report. ▪ Declaration verifying fulfillment of commitments included in the privatization contract; ▪ Declaration of legitimacy of data enclosed in the Yearly Report.

If the specified reporting documentation is not submitted in time, the privatization authority assumes that contract obligations are not performed, thus sanctions are in place. Usually, if a company does not submit a report or the latter is incomplete, the privatization agent undertakes a site inspection.

8. Direct Costs and Time Needed For Report Preparation

There are no standardized amount of costs that companies are forced to spend in the course of reporting to the privatization authorities. Expenses are related mainly to verifications of primary accounting documents, certification/verification of copies, excerpts, experts' appraisals, or protocols. According to the managerial body of some companies that were surveyed, verifications expenses amount up to 50-200 BGN. Companies, which report obligations on conservation of environment, have to pay 200 BGN annual fees to the RIEWP for performance of ecological expertise. Other enterprises pay monthly fee to the RIEWP amounting 50-60 BGN.

On the other hand, some managers do not consider reporting to the PA or MI as direct costs. There are different estimations of time need for preparation of necessary reports. There are also enterprises which managerial bodies do not evaluate time as an expense using the explanation that these documents are anyway made for company's operational use.

Some of the surveyed claim that reporting took significantly more time during the first year than during the years that followed. This can be explained with the quantity of documents required by the PA (respectively MI), but also with lack of personnel experience. In these cases, employees devoted 2-6 weeks for preparation of reporting documentation. In the consequent years reporting process has become a routine, diminishing time expenses.

Analytical Remarks

There is no clear (or at least transparent) rule why some of the companies have to submit reporting documents by the end of January, while others – by the end of March. Probably the second period becomes necessary if the companies are obliged to submit to the Privatization Agency copies of their Balance Sheets, Income and Expenditures Accounts, and other related financial statements, which preparation is associated with the annual reporting period.

Most of the reports submitted to the Privatization Authorities prove fulfillment of assigned obligations, stipulated in the privatization contract. Also submitted are accounting reports, not

directly related to these obligations, and rather presenting the general activity and financial status of the private enterprise. This could indicate that post-privatization control in Bulgaria bears rather wider meaning than what should be its main function - to monitor accurate performance of privatization contract commitments.

In practice, accurate reporting before the PA and MI is important for companies, not only in relation to sanctions. Most of the privatized companies are granted tax preferences according to the Profit Tax Law of 1996. In fact, the privatized companies do not pay 100% of income tax due during first three years after the privatization takes place, and 50% for the fourth and fifth year. In order to qualify for preferences, enterprises should receive a certificate from the PA, demonstrating immaculate performance of assumed obligations (i.e. fulfilling obligations related to investment and employment, etc.). This is achievable only if all reporting documentation is properly submitted and the PA has accepted them.

The reporting requirements, as fixed in the privatization contracts allow for the indefinite and absolute discretionary increase of the volume of documents and information wanted by the privatizing bodies. Reporting by the new owners is virtually disclosure of private information before a public institution; but at the same time the only legal grounds for this disclose is the private contract between the new owner and the privatizing agent. We could not find any clear-cut in this respect between the functions of the privatizing agent as a public institution at one side, and its actions as a party on a private contract on the other. We think that this problem could be overcome, at least partially, as the reporting clauses in the contracts become *exhaustive lists* of the documents required.

Amendments to Privatization Contracts

Practices and Procedures

Out of 11 companies we visited, two have signed amendments to their contracts (one company has 3 amendments signed and one in negotiations, 5 have initiated negotiations for amendments, 1 has only thought about possible amendments, without making any further steps. Three companies claimed they have never even thought of amending the contracts. One of the companies has negotiated amendments related to the way of payment, reduction of employment, changing the type of investment, and now negotiates an amendment which will eliminate an obligation for gasification of the plant. The other company that already signed amendment has negotiated reduction of employment. Three of the other companies also requested reduction of employment, one is in negotiations to restructure debts and investment schedule, and one started informal negotiations on reduction of employment, while it abandoned the idea to reduce the size of investment. One company was considering reduction of employment, but without taking any further steps.

Companies, included in the survey, which:	**Number**
have signed amendments	2
have started negotiations	3
have only thought of amendments	4
have never initiated amendments	5

The commitment, which has most frequently been subject to negotiations, is the level of employment. Two of the companies we visited have already achieved amendments, which

allow for reduction of the number of employed, and another four have initiated negotiations for similar amendments. Companies claimed two major reasons for reduction of employment: contraction of production and sales, and new equipment. The first factor is in a way demand for higher flexibility in employing labor; it has to do with the basic understanding that entrepreneurs would be in favor of more freedom on the labor market.

A milk producing company, owned by a manager-employee firm, managed to sign three agreements. The first one occurred in end-1997 about a year after the deal was signed. It allowed 75% of the remaining payments to be made in government bonds. Thus the buyer paid the entire amount, instead of delaying the payments for 10 years. The second annex of March 1998 allowed for reduction of workers by approximately 10%. The major reason was the decreased milk to be processed, increased competition by other producers in the region, and new equipment installed. As evidence for the decreased amount of milk processed the company had to send supply sheets where individual milk supplies are recorded. The third annex of December 1998 allowed them to change the types of investments laid down in the contract. Sometimes, the investment commitments include not only size but type of equipment as well, which in this case turned into a barrier - the buyer already had invested three times more money during 1998 that scheduled. At present, the company initiated negotiations on the commitment to provide natural gas supply in the plant. Since this step can be made only after gas is brought to the city, the existence of such an obligation for the company sounded quite weird.

Those that did not make any efforts to amend the contract provided interesting reasons. A foreign investor claimed that his company "has no problems related to investment and employment commitments". Another company abandoned the idea to negotiate reduction of investments when they realized that "only the time frame but not the size of the investment were negotiable". "An amendment that delays the investment time schedule also extends the period of government control over our enterprise", said the manager, which was a good enough reason to give up the idea. Another manager claimed that "the PA is a bureaucratic structure, it is easier for them to follow strictly the contracts, and any change annoys them; that is why they will try to prevent any amendment".

Standardized privatization contracts include a provision for notification between the parties in written format only. Hence, the buyer should write a formal letter to the privatization body accompanied with rationale for the demanded change. However, companies that we visited reported that they not only wrote letters, but contacted representatives of the privatization bodies in person. Some of the managers told us that they prefer to bring letters directly to Sofia, and not using the mail. The reason for doing so, according to one of the interviewed was that "if you send the letter by mail it will take a lot of time before it is received by the person in charge to deal with it due to huge bureaucracy in the Privatization Agency (PA)".

Time costs devoted to negotiations seem significant. One manager claimed that the engineers had to prepare a motivated proposal for changing the type of investment, which took them up to 2 months. The process of exchanging letters is also considered small; the companies reported that on average, getting to agreement takes 2-4 months. One company complained they received no answer for more than 3 months, at the time of the interview they were still waiting for a reply. Oftentimes, managers are invited to meet the privatization bodies in person, and it occurs several times before reaching an agreement.

We are not aware for the moment of any written rules that determine the PA or MI criteria for allowing amendments. The procedure as described by representatives of privatization bodies is the following: The requested amendment is studied by a group of 3 experts who propose a

motivated decision to the Executive Director (PA) or the Minister of Industry. Most of the amendments at PA have to be approved by the Supervisory Board. The rule of thumb for investments is that the revised size should not go below the bid of the second-best candidate during the privatization procedure. The general principle also seems to be that investment can be postponed but not reduced. Regarding the employment commitments, the principle seems to be that labor unions in the respective company should support the reduction. According to senior MI official responsible for privatization control "if labor unions agree, reductions in employment commitments happen much more easier". The same official also calculated that 1 out of 5 application for amendments is being approved.

Analytical Remarks

Due to the fact that privatization bodies themselves induced enormous amount of obligations that need monitoring and control that are impossible to perform within the resources available, they fail to react promptly to any requests made by companies. The MI "Control" unit is "overwhelmed with applications for amendments", says MI representative. Therefore, those who seriously plan to amend their contract should put huge efforts, including direct contacts with representatives of the seller. This puts at least a shadow on the transparency of the process.

It seems most requests for amendments demand reduction of employment. This is a direct consequence of the inconsistent policy of privatization bodies to put investment and at the same time increase in employment in privatization contracts. The simultaneous increase in employment and investment might happen only when the specific market is expanding fast; other thing being equal, improvement in technology leads to reduction of labor needed.

The PA recognizes that business environment is changing fast and unexpectedly. The war in FR Yugoslavia is now considered as major factor, together with the last year shock in Russia. The PA therefore accepts some flexibility that allows for amendment of contracts signed during different conditions. However, the standard clause that envisages "extraordinary events, such as war, natural calamity, etc." and provides excuse for changing the obligations of the buyer, has never been used so far.

At the same time, the PA complains of permanent checks and audits by the Accounting Chamber. The latter attacks any initiative that "harms" the interest of the state budget. On the other hand, there is a strong political pressure to keep contracts as initially signed.

The major feeling from the meetings with PA and MI officials is that they understand the necessity of flexible privatization contracts. They claim that any motivated application for amendment that will improve the overall performance of the plant would be approved. They seem to understand that employing workers above certain threshold might threaten the very existence of the company, thus even further increasing unemployment. A PA representative referred to a case of a company, which is at present violating he employment clause, and is forced to pay penalties. "Had the company ever applied for amendment, we would have granted one", said the PA official.

It seems that privatization bodies are called to do quite difficult and inconsistent tasks. On the one hand, there is a deep-rooted understanding that the State can and should retain control over the economy through privatization contracts. This is particularly true about investments and employment: the PA, when preparing privatization procedure, does assessment of needed

investment in the enterprise, in a desperate attempts to do some planning; employment commitments are understood as a major tool of the government social policy.

On the other hand, the privatization bodies, and the government as a whole, recognize the impossibility of this "social engineering mission". They seem to understand that, first, owners are the ones that can best take decisions related to the effectiveness of a given company, and second, that market conditions are changing, and no one is able to predict the 5 year future (meanwhile, the MI claimed that after 1998 all commitments in privatization contracts extend to only 3 years). Therefore, amendments become more and more easy to negotiate. Then, the reasons, be they political or social, behind putting future commitments in contracts, become futile. The message sent to potential buyers is, therefore, "we will verify that you *deserve* the enterprise by your business plan; be sure that you follow your promises, otherwise we will make you pay or we will take away you tax preference; on the other hand, we, but only we, can provide you with amendment in case you are in trouble".

Sanctions

The common conclusion from the interviews with the eleven companies is that buyers fearing sanctions rather compromise with company's strategy than pay forfeits. And this totally coincides with the initial idea behind setting sanctions size - "these are designed as an incentive for the Buyer to keep obligations assumed".

Sanctions imposed in cases of failure to fulfill Buyer's obligations are more or less standardized in contracts signed with the Privatization Agency and/or the Ministry of Economy. This is because they are regulated by the Ordinance on tenders, and from the other side - both the Privatization Agency and the Ministry of Economy follow one and the same methodology for post-privatization control.

9. Types of sanctions and ways/reasons to dissolve a contract

All contracts have a clause for committing a specified volume of investments, as well as maintaining an average number of employed in the privatized enterprise with respective sanctioning arrangements in case fulfillment of obligations fails. Other obligations assumed by enterprises are negotiated separately for each specific case, though sanctions remain similar. For any breach of obligations, sanctioning can be:

- Forfeits for breach of obligations, and/or
- Dissolving the contract (as ultimate sanctioning).

The above two types of sanctions are inter-related, whereas the Ordinance on tenders stipulates that the contract may be dissolved unilaterally by the Seller if forfeits have been calculated for more than 45 days. If the contract is dissolved, the Buyer dues the suspended income taxes according to Art. 58 of the adopted in 1996, Section 7 of the Corporate Tax Law. It appears that such a peculiar sanction stimulates Buyers to rather fulfil assumed obligations. There is an option, according to which the Buyers avoids to be sanctioned when breach of obligations is because of *force majeure* circumstances.

The PA and the MI practices assume that an enterprise does not fulfil contract obligations when the stipulated reporting documentation is not received in time. It is possible that a particular privatization contract includes a clause referring to ***(non) respecting reporting deadlines.*** For

instance, some of the contracts stipulate that if the Buyer delays report on committed investments submission, a forfeit is imposed amounting 0.1% of the basic interest rate for the period on each overdue day till March 1st of the current year. After this period is over, the Seller (in the studied case - it was the PA) has the right to dissolve the contract.

According to the Ordinance on tenders, when the ***price*** is not paid (or the first tranche is not transferred) within seven days after the contractual term is expired, the seller may dissolve the contract unilaterally. Additionally, the Buyer owes interest (according to Law on Interest Over Taxes, Fees and Other Similar State Claims) on payments postponed. In some contracts, similarly to the reporting deadlines clause, except from the determined sanction, Buyer's due payments are burdened by 0.1% per overdue day. If delay continues more than 45 days, again the Seller has the right to unilaterally dissolve the contract.

When breach of obligations for ***maintaining average number of employees*** of the privatized enterprise occurs, the Buyer owes forfeit amounting 150 % of the average wage[33] for the country per each not provided work place. As mentioned above, the privatizing authority can unilaterally dissolve the contract if forfeits have been calculated for longer than 45 days.

Privatizing authorities have introduced some amendments in specified contracts, e. g. in the clause stating that (quoted as in the privatization contracts):
▪ "The SELLER has the right to unilaterally dissolve the present Contract upon written notice in cases when the BUYER reduces number of jobs with more than 30 % within 45 days in contradiction with Art.… for the current year."
▪ "The SELLER has the right to unilaterally dissolve the present Contract, …, if the BUYER reduces number of jobs with more than 30% in contradiction with Art. …"

If the Buyer does not commit the ***investments***, assigned with the contract, he/she owes sanctions of 50% of non-performed investment, according to the Ordinance. In two of the enterprises we conducted interviews, we were informed that sanction on non-committed investment amounts 30% of the latter. Since no contract was shown to us, we cannot claim this is valid. Similar to the above-described clause on number of employees, the privatizing authority has the right to unilaterally dissolve the contract, when forfeit has been calculated for more than 45 days. There is a slight variation, i.e. the Seller has the right to unilaterally dissolve the contract if the Buyer does not commit 30% or more of the total volume of contracted investments for the current year.

Another standard obligation Buyers commonly assign to is ***non-transferring and/or using as a collateral shares*** of the privatized company for a specified period - usually 5 years. If this obligation is not fulfilled, the Buyer owes sanctions for each transferred share, amounting 100% of share's value.

Similar is the clause included in some contracts referring to a "ban" on sale of the long-term tangible assets (usually for a period of 5 years). Commonly, considered is a certain percentage of the entered property, whereas the amount of the sanction is selected between its market value or the value entered in the balance sheets - whichever is bigger.

[33] We were told in one of the surveyed companies, that the sanction according to their privatization contract is calculated based on the minimal wage. We confide with this statement, although no contract was shown to us.

Since most of the privatized enterprises were responsible anyhow in the past to maintain certain ***wartime stock and state reserves***, this obligation is transferred to the new owners. The sanction in place varies from 110% of the market value of secured produce, to dissolving the contract.

Another commonly presented obligation of the Buyer is ***overtaking liabilities*** of the privatized company towards banks, the State budget and other enterprises. In this case, a separate agreement with creditors is signed. If the Buyer does not submit to the privatizing authority such an agreement in time, the latter has the right to unilaterally dissolve the contract. On the other side, if liabilities payment is postponed, a forfeit is dies amounting 0.06% from the tranche per day.

Failing to fulfill the obligations to preserve previous business activity, protection of environment, etc. can bring imposing sanctions, which should be agreed by the parties and included in the contract clauses. Unfortunately, we are not in a position to determine these limitations.

According to representatives of privatizing authorities, the clause of conservation of environment is included in order to 'remind' the Buyer to respect the Environmental Protection Act. Fulfillment of such clause is monitored (as well imposing sanctions) by the RIEWP.

10. Mechanisms to impose sanctions

In case of noticing failure obligations on behalf of the Buyer, the employees of the respective department of the privatization authority (e.g. Privatization Process Control in the PA, or Control Department at the General Department Privatization of the MI), are sending letters determining terms for sanctions payment (usually within 30 days). If this period is violated, a Court Claim follows. Contract disputes are solved according to Code of Civil Procedure regulations.

A foreign investor, bought an enterprise in the wood-processing industry is due sanctions for the past three years for failing to perform obligations, but not paying. The PA has won one lawsuit against him, and the other are in process. Another example of PA practice is a foreign investor who paid sanctions for two years on failing to maintain number of employed. In the third year, when amount due reached 3,000 BGN, the investor files for signing an annex to the contract.

At present, the Sofia City Court is working on 40 claims submitted by the Privatization Agency. Though, Agency's representatives admit that annulling a contract is procedurally difficult. There is no description of such a procedure in the Privatization Act. Transferring back shares should be voluntarily. Even if the PA endorses these shares, it [the PA] has no money to cover them, because the Ministry of Finance disposes of the revenues from privatization.

The MI showed us a feasible scheme for solving the above problem (and it is used at present). If the MEBO buys an EOOD (an Ltd. formed by one person), a mortgage constituted or the privatized company's shares are pledged in favour of the MI.

In this situation the new owner is impeded from applying for a bank credit, because there is no reliable coverage for the sources - no bank would extend credit (and if yes, then under unfavourable conditions for the recipient) if the long-term tangible assets or shares are used already as a collateral.

The MI has not processed any cases or surrendered claims in the Court. Since 1997, 10 enterprises privatized by the MI have paid forfeits, and 10 more have their contracts annulled for non-payment of the price.

Analytical Remarks

While working on the project it turned out that people involved in post-privatization control from PA and MI differ to a big extend regarding the necessity of such a control and imposing sanctions. Some entirely renounce the need of control and sanctions. Also, a representative of the PA shared with us her viewpoint that control should be tightened, and forfeits are to be regulated with a Law on State Claims in order to solve problems faster.

Presently, a question arises "which are the leading grounds for determining sanctions in each specific case". When choosing mild or strict sanctions, important is the state the privatized enterprise is in; but also Buyer's good image; company's capacity to negotiate more favourable conditions, or a mixture of these criteria. Whether someone in the privatizing authority carries out a preliminary analysis of the particular sector and environment; if there are rational grounds for each of the obligations assumed, chances of failure because of *force majeure* obstacles. And only after considering all peculiarities, sanctions should be set.

Buyers themselves recognize that sanctions are the biggest threat to them. Only one of new owners surveyed was explicit: "I have no money for sanctions. If they [the privatization authority] do not like what I do - let them have back the factory."

Here arises the question why is it necessary to impose sanctions at all, if representatives of PA and MI are responsive enough to amend - if needed - contract clauses. In practice, Buyers do not make best use of available opportunities to additionally negotiate contracts clauses (it should be mentioned that procedures of approval of pleas for clauses amendments is a sluggish bureaucratic procedure) from the other side, as a representative of the privatization authority told us, some Buyers exaggerate when setting obligations, in order to acquire the enterprises, and problems follow.

11. Problems

Companies' View: Business Strategies vs. Privatization Commitments

The business plans' parameters, proposed by the candidates themselves, usually become the new owners' non-price future commitments. These are mainly engagements regarding number of employees, investments, and in certain cases concrete environmental commitments and commitments related to wages. In every company that we visited, privatized via tender or negotiations with more than one candidate, we found huge gaps between the actual business strategy of the buyer and the business plan submitted to the privatization body. The new owners shared that "the business plans submitted to the respective privatizing body had nothing to do

with the actual business prospects of their companies." Moreover, the public officials in the privatizing authorities are obviously aware of this practice.

We found out that every company, included in the survey, faces certain problems related to one or more of the non-price future commitments. The heaviness of the difficulties varies according to the case: in some companies the non-price commitments mean only additional costs (most often negligible) for reporting, but in others they threaten the company's existence. Nevertheless, in most cases (companies that we visited or we were told of in the PA and the MI) there was a conflict between the companies' business strategies and their privatization commitments. Also there is a positive correlation between the heaviness of the commitment-related problems and the hardness of the competition during the privatization procedure.

Problems Related to the Labor Commitments

From the socialist years Bulgaria inherited industry characterized by a phenomenon known as the "hidden" unemployment, meaning that companies were operating beyond the optimal level of employment. It was at the expense of the average productivity (and thus wages) and the cost-competitiveness of the state-owned enterprises. The structural change needed in the state-owned sector therefore presupposed reduction of the average number of stuff in most of the companies. We are not certain that the privatization policy ultimately aimed at such structural changes, but in all cases the privatization authorities should have considered the staff releases in most of the companies as absolute necessity.

Problems related to the labor commitments we encountered virtually in all of the companies that we visited. What is more, the privatization bodies' officials claimed that most of the submitted requests for contract amendments concern the employment clauses. Most of the companies, included in the survey, have faced or currently face problems maintaining the average number of staff defined in the privatization contract (in some cases the contracts stipulate not only maintaining certain number of employees but increasing the average number in the span of 3 or 5 years). Such companies claim that if there were no employment commitments they would have reduced the average number of staff between 10 and 38 per cent.

Another labor-related problem appears when there are trade unions represented in the company, which usually means a collective labor contract. When a company has negotiated a "soft" kind of employment clause, i. e. maintaining certain level of the average number of staff but lower than the pre-privatization levels, the privatization contract allows it to dismiss some of the employees. However, when a collective labor contract exists, there are usually limits (defined as per cent of the total number of employees, usually 5 per cent), within which employees could be dismissed. We encountered cases where the privatization contract is inconsistent with the labor legislation regarding cutting down the average number of staff, since the contract allowed for bigger releases of personnel than possible according to the collective labor contract.

Problems Stemming from Other Commitments

The second most frequently met problem in the companies visited, as well as among the requests for contract amendments sent to the privatizing agents, stems from the *investment*

commitments. Although the investment obligations are much more consistent with the companies' strategies than the employment commitments, it happens that during periods of weak sales the companies' expenditures could hardly go beyond their operational costs. Additionally, due to the changing market environment in Bulgaria, commitments for investment undertaken in a given moment under given business environment might have completely different dimensions and effects after four or five years. In such cases the new owners usually apply for postponement of their investment commitments. Problems for some companies stem also from the engagement to invest according to a certain program, which includes specific types of machines and equipment.

In almost all of the cases companies meet problems related to fulfillment of their investment commitments if the amounts of future investment are denominated in foreign currency (most frequently, USD). On the contrary, almost all of the enterprises, included in our case study, which privatization contracts stipulate investment in domestic currency, do not face problems with the fulfillment of their investment programs. It is understandable, since most of the contracts were signed in 1996-1997 when Bulgarian currency depreciated by 624% against the USD, and there were several months (December 1996 - February 1997) of record hyperinflation.

Prior to 1999, there were periods when the import of machinery and equipment in the form of foreign investment was exempt from taxes and customs duties. Some companies made use of this opportunity and declared five times bigger total value of the investment. In this cases, the investment plan was fulfilled according to reporting documents and balance sheets, but the real value of the investment was considerably lower.

The *ban on using the shares in the privatized company as collateral* seems to be the cause for a significant problem, although met only once in the survey, namely this commitment reduces the company's access to capital. However, an easy way out could be establishing a new company, via which the new owner acquires the privatized enterprise. Then it is possible to use the shares in the new company (and thus indirectly the shares of the privatized one) as collateral.

Management-employee companies that have used the 10-year deferred payment option, are usually obliged to report before the privatizing authorities during the whole 10-year period. When such a company has paid the whole price before the deadline (e. g. in the first two years), it still has the obligation to report during the whole period defined according to the deferred payment scheme. It turns out then that in such cases the owners should continue reporting beyond the expiration of both the price and non-price commitments.

There is no legal requirement that the state-owned enterprises have "clear" files, i. e. no debts, no restitution claims, etc., before they are transformed into commercial companies and privatized. Restitution claims remained pending for the lands of most of the companies even after their privatization. The privatizing agents normally keep minority stakes in the companies with the only purpose satisfying such claims with shares in the privatized company. We have encountered several cases, however, where the new owners are due to satisfy additional restitution claims, i. e. claims beyond the state-owned stake of shares kept for such purposes. The main problem in such cases stems from the lack of land cadaster. In some companies the restitution claims submitted are for areas several times bigger than those owned by the company.

Analytical Remarks

Although the officials at the privatizing agents are aware of the gaps between business plans submitted and actual strategies, there is little sign that they have changed anything substantial in its causes. Namely the use of "closed" privatization techniques, i. e. tenders and negotiations, as well as the unclear rules of buyer selection, have determined the exaggerated figures (regarding especially the average number of staff) in the business plans compared to the buyers' strategies.

Besides the non-price commitments resulting from the business plans, we encountered a bulk of commitments that have been suggested (or imposed) by the privatizing authorities, and in most cases have been accepted by the candidates (especially when there was a hard competition between the candidates). However, accepting certain commitments means no consistency with the actual business strategies. When there was a hard competition for a company the candidates could hardly reject commitments suggested by the privatizing agent.

The actual business strategies of the new owners in most cases would include restructuring of the company, aiming to achieve eventually higher productivity and profitability. Commitments such as keeping the previous activity, maintaining certain employment, and not selling fixed tangible assets, would obviously impede such intentions. It is worth to be noticed also that the fulfilment of future commitments by the selected buyer in the general case depends on at least two conditions, which are external for the new owner. Namely these are:

- Privatized company's capacity as the private owner inherited it.
- Other shareholders' will.

The problem with maintaining the (too high) average number of staff meets several possible solutions:

- Amending the privatization contract – reducing the figure in the employment clause;
- Reducing the average number of staff without amending the contract, and paying sanctions;
- Reducing the average wages, whilst maintaining the average number of staff;
- Informal agreement with the workers to take non-paid holiday (usually several months), and so maintaining the average number of staff. In some cases the maternity leaves (for example) are included in the list of average employment, so the average number of workers is bigger than the real number. At the same time maternity leaves receive money from Social Insurance Institute, not from their employer.
- Operating within lower than optimal profit margins because of the increased labor costs.

Keeping higher than the optimal level of employment for these companies (especially for the companies operating in highly competitive markets) in the general case means lower productivity and lower wages, as well as narrower profit margins. We were convinced that if the companies succeed in their effort to amend the contracts, the average wages in their plants would be raised (in some cases up to 40 %).

The executive director of one of studied privatized companies argued that it would be better to pay minimal wage to the extra staff to stay home instead of taking the risk of contract cancellation. Additional argument is the fact that the enterprise has embraced the above mentioned tax preferences according to the Profit Tax Law of 1996. In this case if the commitments stipulated in the privatization

contract are not fulfilled, the enterprise should compensate for the income tax due but not paid during five years following privatization.

12. Conclusions and Recommendations

Conclusions

There is a prevailing among the privatizing bodies' officials perception of privatization as a process, which aims at *developing the company*, i. e. their job is not just transferring the property, but also finding the "good" new owners and having them committed to "develop" the companies. This is the main motive behind the prevailing use of "closed" procedures, i. e. tenders and negotiations. For, according to the privatizing authorities, they allow for the better selection of buyer, because the evaluation of different offers is made on the basis of more than one (the price) criterion. The results of this vicious practice are:

- Privatization procedure loses its transparency;
- Candidates are led into a blind competition, which forces them to submit business plans (i. e. non-price future commitments if they buy the company) which are hardly achievable.
- Differences in the access to information for insiders and outsiders occur.

Besides, we believe that the "closed" procedures decrease the potential amount of privatization revenues at least for following three, already mentioned above, reasons: there is a certain trade-off between the price and the other commitments; the rules of the game are unclear, which prevents broader investor interest, which mean lower demand and lower price for the company; the high discretionary power, resulting from the unclear rules for buyer selection, in certain cases may not lead to the selection of the best offer.
Thus we consider the prevailing use of tenders and negotiation to have high opportunity cost in terms of missed cash flows to the budget.

The evaluation of candidates' offers based on several incomparable (and some of them not quantifiable at all) criteria naturally leads to the vast variety of non-price future obligations. The most persistent among them are

- *Maintaining a certain average number of staff*
- *Certain volume of investments*
- *Preserving company's previous activity*.

The preservation of company's previous activity guarantees that the company will continue its operation. The privatizing authorities consider investments the primary source of companies' development. Finally, the employment clauses are supported by the social reasoning of the state officials, i. e. this is part of the "fight against unemployment". Besides the generally applicable commitment clauses, in our survey of 11 companies we encountered a number of specific commitments applicable only to particular cases. Some of the clauses refer to or repeat existing general norms or obligations stemming from other private relations. Such are preserving the environment, maintaining the state reserve and war-time stock., and sticking to the contracts with third parties signed prior to the company's privatization (including collective labor contracts). We consider the existence of such repetitive clauses legally unjustifiable.

The following non-price future commitments have the most negative effect on the privatized companies either by preventing the new owners from restructuring the company, or by jeopardizing company's current operation:

- Maintaining a certain average number of staff.
  - Not selling fixed tangible assets.
  - Not using the shares in the privatized company as collateral.
  - Implementing an investment plan, fixing volumes of yearly investments and types of investments.

Besides, the use of the ban of the sale of shares has to certain extend prevented the faster development of Bulgaria's capital market.

The uses of "closed" privatization techniques, as well as the unclear rules of buyer selection, have determined the gaps between business plans submitted and actual strategies. The actual business strategies of the new owners in most cases would include restructuring of the company, aiming to achieve eventually higher productivity and profitability. Commitments such as keeping the previous activity, maintaining certain employment, and not selling fixed tangible assets, would obviously impede such intentions.

Besides the commitments resulting from the business plans, we encountered a bulk of commitments that have been suggested (or imposed) by the privatizing authorities, and in most cases have been accepted by the candidates (especially when there was a hard competition between the candidates). However, accepting certain commitments meant in no way consistency with the actual business strategies. When there was a hard competition for a company the candidates could hardly reject commitments suggested by the privatizing agent.

The very existence of the non-price future commitments predetermines and justifies the post-privatization control. However, the basis of privatization control is the Contracts and Obligations Law, in other words, the general civil law. Thus the state via the PA and other privatization bodies turns into mere party to bilateral contract. Therefore, no limits to administrative power are possible; privatization bodies can establish the rules of the game, the procedures, the sanctions, such as any individual party to contractual agreement can do. This is a *prima facie* argument for the existence of privatization control.

It seems that most frequent requests for amendments to the privatization contracts demand reduction of employment in the companies. This is a direct consequence of the inconsistent policy of privatization bodies to put investment and at the same time increase in employment in privatization contracts. The simultaneous increase in employment and investment might happen only when the specific market is expanding fast; other thing being equal, improvement in technology leads to reduction of labor needed. The major feeling, however, from the meetings with PA and MI officials is that they understand the necessity of flexible privatization contracts. They seem to understand that employing workers above certain threshold might threaten the very existence of the company, thus even further increasing unemployment.

It seems that privatization bodies are called to do quite difficult and inconsistent tasks. On the one hand, there is a deep-rooted understanding that the State can and should retain control over the economy through privatization contracts. On the other hand, the privatization bodies, and the government as a whole, recognize the impossibility of this "social engineering mission". They seem to understand that, first, owners are the ones that can best take decisions related to the effectiveness of a given company, and second, that market conditions are changing, and no

one is able to predict the 5 year future (meanwhile, the MI claimed that after 1998 all non-price commitments in privatization contracts extend to only 3 years). Therefore, amendments become more and more easy to negotiate. Then, the reasons, be they political or social, behind putting non-price future commitments in contracts, become futile. The message sent to potential buyers is, therefore, "we will verify that you *deserve* the enterprise by your business plan; be sure that you follow your promises, otherwise we will make you pay or we will take away you tax preference; on the other hand, we, but only we, can provide you with amendment in case you are in trouble".

One of the most peculiar facts about non-price commitments and respective sanctions is that if employment is reduced below the negotiated numbers, the buyer has to pay compensation to the state, usually 150% of the average salary for the country. This does not seem to solve social problems stemming from possible lay-offs. People who are laid off in a privatization company are those who suffer, not the state; it would be much more rational (or fair) that they get any sort of compensation by the new owner of the enterprise. The current situation implies that employers that reduce jobs harm the state, not those who lose their employment; this assumption justifies any further involvement by the government in corporate strategies related to labor and employment.

Privatization control therefore turns in mere formal procedure and a possible tool for harassment when needed. Site audits are rare, most reports are collected and stored for evidence, and only total numbers are checked for reconciliation. Sometimes controlling agents help companies prepare the reports. It turned that control procedures *per se* do not cause excessive direct burden for companies. Moreover, it seems that reasonable applications for amendment of contracts might come to success. Therefore, privatization control cannot ensure perfect execution of all contracts, it cannot also stop layoffs if business conditions require it. The only function it rests with is a tool of the government policy for intervention in economic affairs; a tool in the *sticks-and-carrots* game.

The above-mentioned observations question the ground for the very existence of privatization control. The idea that a government institution must have a say when an investor is planning his activities for the following 5 years lacks economic rationale. Understandably, the legislator has provided no explicit provision that would allow privatization bodies to monitor the performance of privately owned companies. The "invention" of privatization bodies to organize post-privatization control therefore might be explained only by their strife to maintain state interference in the economy.

Recommendations

We recommend that the privatizing agents start using predominantly "open" procedures – auctions and public offering – not only for the detached units but also for the whole companies. This will have the following positive implications:

- Higher speed of the procedures.
- Higher transparency of the process.
- Higher and faster revenues (as the price will be the only criterion for buyer selection).
- Fostering capital market development (valid for the public offering scheme).

When tender or negotiations are to be used, the evaluation criteria should:

- Be exhaustively listed in the Decision for privatization.
- Be quantifiable and comparable to each other.
- Have evaluation weight, which is preliminary announced to the candidates.

This will 1) reduce the possibilities for discretionary evaluation, and 2) help the candidates submit business plans consistent with their actual business intentions.

The very idea behind post-privatization control is that the government should have means to interfere in the economy; in a market economy this assumption should be abandoned. We recommend that non-price future commitments, being a major impediment before the companies' eventual restructuring, be avoided in the privatization contracts. This recommendation could be applied to the existing contracts, as a general regulation is adopted, which amends the contracts in this respect. The lack (or significant decrease) of future commitments should result in the absence (or significant narrowing) of the control activities of the privatization authorities. Should this be taken under consideration, we foresee the following positive direct effects:

- Fostering the process of restructuring of the ex-state owned companies, leading to improved competitiveness and increased productivity;
- Reducing the time and direct costs that companies spend on reporting before the privatizing agent;
- More efficient use of the privatizing bodies' staff, as the monitoring activities will be minimized;
- Friendlier environment for the potential foreign companies entering Bulgaria via privatization.